

DECLARATION

Though some acknowledgments have been made, I do not know of any other sources of the data. The work has not been submitted previously for publication or for any other academic award.

Governance of Listed State-owned Enterprises in China: The Rise of a New State-led Model?

A thesis submitted for the degree of Doctor of Philosophy of the
Australian National University

Jian Rong (Jenny) Fu

January 2014

DECLARATION

Except where due acknowledgment has been made, I declare that I am the sole author of this thesis. The work has not been submitted previously, in whole or part, to qualify for any other academic award.

Signature of Candidate:.....

Date: 22 January 2004

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I am greatly indebted to my family and friends for their constant love and support. In particular, my husband John Gray's constant understanding of my Chinese political economy has always made him the first person I shared ideas with during the project.

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- Chapter 10 was presented at the Second Australia-China Investment Relations Conference, Beijing, China, 18 September 2013.

ABBREVIATIONS

ACEF	All-China Environment Federation
ACFTU	All-China Federation of Trade Unions
ACLA	All China Lawyers' Association
ARC	Australian Research Council
CAO	China Aviation Oil
CASS	China Academy of Social Science
CCP	Chinese Communist Party
CMEs	Coordinated Market Economies
CNPC	China National Petroleum Corporation
CSRC	China Securities Regulatory Commission
Central SOEs	Central Government-affiliated State-owned Enterprises
GFC	Global Financial Crisis
IIF	Institute of International Finance
LLSV	La Porta, Lopez-de-Silanes, Shleifer and Vishny
LMEs	Liberal Market Economies
NAO	National Audit Office
OECD	Organisation for Economic Cooperation and Development
PRC	People's Republic of China
QFII	Qualified Foreign Institutional Investor
SAFE	State Administration of Foreign Exchange
SAQSIQ	State Administration of Quality Supervision, Inspection and Quarantine
SASAC	State-owned Assets Supervision and Administration Commission
SINOPEC	China Petrochemical Corporation
SOE	State-owned Enterprise

China introduced major reforms to its decade-old *Company Law* and *Securities Law* in October 2005. The aim of this thesis is to reexamine China's post-2005 legal and regulatory reforms concerning governance of listed SOEs and explore whether these reforms have given rise to a new model of corporate governance. The research questions are examined through the lens of state capitalism and limited and change liability, as the thesis draws upon these strands of literature, namely, comparative capitalism, comparative corporate governance, and law and capitalism, particularly Williams and Paine's postulation of the role of the state in conditioning the interaction between legal and economic changes in state-led economies.¹

While corporate governance is a vast area, this thesis focuses on the evolution of Chinese law and practice concerning three sets of company relations central to the former state-led model of corporate governance. These are shareholder relations, as state protection and non-shareholder stakeholders (including employees) protection. Closely related to the post-war state-led economies was the law itself, the model was also reflected in the governance of Chinese listed SOEs prior to the 2005 corporate law reforms.

This thesis argues that China's post-2005 evolution of these three sets of relations has undergone significant changes. However, these changes have not led to a greater convergence to the governance of Chinese listed SOEs with the Anglo-American outsider-based model, as widely suggested in the literature. What has emerged from China's post-2005 reforms is a new state-led model that can be called a 'corporate shareholder' approach. While state involvement in corporate affairs remains strong, this model pays equal attention to strengthening monitoring of managers and the protection of minority shareholders and other non-shareholder stakeholders, namely, limited to employees. Although difficult to reconcile with the insider-based model, the rise of this new model in China cannot be explained from an effort to reconcile the Chinese form of state-led economic development, while grappling with the increasing demands made on the state for protection by investors and other stakeholders.

¹ Curtis Williams and Katherine Paine, *Law and Capitalism: How Capitalism Evolves Across Legal Systems and Government Development around the World* (University of Chicago Press, 2008) ch. 2.

ABSTRACT

China introduced major reforms to its decade-old *Company Law* and *Securities Law* in October 2005. The aim of this thesis is to (re)interpret China's post-2005 legal and regulatory reforms concerning governance of listed SOEs and explore whether these reforms have given rise to a new model of corporate governance. The developments are examined through the lens of state capitalism and institutional change. In doing so, the thesis draws upon three strands of literature, namely, comparative capitalism, comparative corporate governance and law and capitalism, particularly Milhaupt and Pistor's postulation of the role of the state in conditioning the interaction between legal and economic changes in state-led economies.¹

While corporate governance is a vast area, this thesis focuses on the evolution of Chinese law and practice concerning three sets of company relations central to the former state-led model of corporate governance. These are state-manager relations, investor protection and non-shareholder stakeholder (including employee) protection. Commonly adopted in the post-war state-led economies until the late 1980s, this model was also reflected in the governance of Chinese listed SOEs prior to the 2005 corporate law reforms.

This thesis argues that China's post-2005 regulation of these three sets of relations has undergone significant changes. However, these changes have not led to a greater convergence in the governance of Chinese listed SOEs with the Anglo-American outsider-based model, as widely suggested in the literature. What has emerged from China's post-2005 reforms is a new state-led model that can be called 'a state-led stakeholder' approach. While state involvement in corporate affairs remains strong, this model pays equal attention to strengthening monitoring of managers and the protection of minority shareholders and other non-shareholder stakeholders, including, but not limited to employees. Although difficult to reconcile with the outsider-based model, the rise of this new model in China cannot be separated from its efforts to maintain the Chinese form of state-led economic development, while grappling with the increasing demands made on the state for protection by investors and other stakeholders.

¹ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) ch 2.

The emergence of this new state-led model has been better reflected in the Chinese post-2005 regulatory framework, than the reality of corporate governance in listed SOEs. The lack of more radical changes in the latter respect has been, in part, caused by various disadvantages associated with the state as essentially the sole guardian of this new governance model.

The long-term viability of this model is likely to hinge on the balance between the will and capacity of the state to adjust its competing goals and the diverse interests within listed SOEs, and the risk of lax internal controls that persists at the corporate level. However, due in part to its general congruence with the Chinese state-led economic development, the continued evolution of this model is likely to be incremental. As such, the articulation of the state-led stakeholder model of corporate governance makes a significant contribution to our understanding of not only Chinese corporate governance, but also comparative corporate governance and comparative capitalism more broadly.

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CHAPTER 1 INTRODUCTION

1.1 Introduction

[The] free-market tide has now receded. In its place has come state capitalism, a system in which the state functions as the leading economic actor and uses markets primarily for political gain. This trend has stoked a new global competition, not between rival political ideologies but between competing economic models.¹

China introduced major reforms to its *Company Law* and *Securities Law* in October 2005. The 1993 *Company Law*² and 1998 *Securities Law*,³ preoccupied with facilitating the corporatisation of state-owned enterprises (SOEs), largely ignored corporate governance issues such as the protection of minority shareholders. With the adoption of 'more traditional corporate governance objectives',⁴ the 2005 amendments⁵ were generally commended as having significantly modernised or Westernised the Chinese systems of corporate law and corporate governance.⁶

The aim of this thesis is to (re)interpret China's post-2005 legal and regulatory reforms concerning the governance of listed SOEs (or state-controlled listed companies), and explore whether these reforms have given rise to a new model of corporate governance, or simply indicate that the Chinese system has moved one step closer to the Anglo-American outsider-based/shareholder model, as widely suggested in the literature. As will be illustrated in Chapter 2, these companies have remained the dominant force on the Chinese stock market, despite the rapid expansion of the private sector.

¹ Ian Bremmer, 'State Capitalism Comes of Age' (2009) 88 *Foreign Affairs* 40, 41.

² 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993.

³ 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1998.

⁴ Roman Tomasic, 'Looking at Corporate Governance in China's Large Companies: Is the Glass Half Full or Half Empty?' in Guanghua Yu (ed) *The Development of the Chinese Legal System Change and Challenges* (Routledge, 2010) 182, 195.

⁵ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005 ('2005 PRC Company Law'); 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005.

⁶ See, eg, James V. Feinerman, 'New Hope for Corporate Governance in China?' in Donald Clarke (ed) *China's Legal System: New Developments, New Challenges* (Cambridge University Press, 2008) 36, 57; Baoshu Wang and Hui Huang, 'China's New Company Law and Securities Law: an Overview and Assessment' (2006) 19 *Australian Journal of Corporate Law* 229, 239; Gu Minkang, *Understanding Chinese Company Law* (Hong Kong University Press, 2010), 4, 367-375; Nicholas Howson, 'Corporate Law in the Shanghai People's Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State' (2010) 5 *East Asia Law Review* 303, 327; Cheng Wei-qi, 'Protection of Minority Shareholders after the New Company Law: 26 Case Studies' (2010) 4 *International Law and Management* 283, 283.

This research was inspired by a perceived disjuncture between two growing strands of literature on China. As Chapter 2 will further illustrate, on the one hand, consistent with the supremacy of the Anglo-American model of corporate governance at least until the recent Global Financial Crisis (GFC), research on Chinese corporate governance has mainly focused on how the mechanisms of that model could be emulated to improve the governance of listed companies, primarily listed SOEs, in China. Two questions have underlined this strand of research, namely, how can we make the governance of listed SOEs more similar to the Anglo-American model? If we cannot, what are the main obstacles?

On the other hand, in contrast with the ongoing primacy of the outsider-based model in research on Chinese corporate governance, there have been some signs of change in the literature on the Chinese model of economic development. Until the early 2000s, the Chinese approach to economic growth and development had been generally considered an incremental approach, in contrast to the various 'big bang' strategies adopted by the former Soviet Union and East European countries in their transformation from a planned state to market economy.⁷ However, instead of portraying China as 'a way-station on the road to liberal capitalism',⁸ recent political economic studies highlight a distinct model of economic development employed by Chinese policy makers, namely 'state-led capitalism' or its short form 'state capitalism'.⁹

The term 'state capitalism' has no universally agreed meaning. Lenin distinguished two types of state capitalism, each based upon the combination of the state with monopoly capital. The first is the state monopoly capitalism as the highest stage of capitalism. It denotes a phenomenon where a bourgeois government controls the whole economic system for the benefit of the capitalist class.¹⁰ The second is state directing capitalist

⁷ Minxin Pei, *China's Trapped Transition: the Limits of Developmental Autocracy* (Harvard University Press, 2006) 25-27. For an account of the Chinese gradualist reforms in its early reform stages, see Ron Duncan and Yiping Huang (eds) *Reform of State-owned Enterprises in China: Autonomy, Incentives and Competition* (NCDS Asian Pacific Press, 1998); Barry Naughton, *Growing out of the Plan: Chinese Economic Reform, 1978-1993* (Cambridge University Press, 1996); Barry Naughton, *The Chinese Economy: Transitions and Growth* (The MIT Press, 2007).

⁸ Derek Bacon, 'Emerging-market Multinationals: The Rise of State Capitalism', *The Economist* (online) (21 January 2012) <<http://www.economist.com/node/21542930>>.

⁹ Ibid. See also Ian Bremmer, *The End of the Free Market: Who Wins the War between States and Corporations?* (Portfolio, 2010) 4-5; G. John Ikenberry, 'The Future of the Liberal World Order' (2011) 90 *Foreign Affairs* 56, 57.

¹⁰ H. Ray Buchanan, 'Lenin and Bukharin on the Transition from Capitalism to Socialism: The Meshchersky Controversy, 1918' (1976) 28 *Soviet Studies* 66, 67.

undertakings as a mechanism for the transition from capitalism to socialism.¹¹ State capitalism took on many new forms after World War II. These included the East Asian ‘developmental states’, in which the state coordinated closely with large private firms to promote economic growth and development, state ownership of certain industries in Western European countries, and the indicative planning in France and India.¹² As noted by Lin, ‘the degree and variation of state capitalism can be distinguished by two dimensions: ‘(1) the extent to which the state owns the means of production; and (ii) the extent to which the state dictates or coordinates with big firms (national champions) and unions in the market place’.¹³ All forms of state capitalism, however, entail a system ‘in which the state plays a significant and visible role’ to promote economic development.¹⁴ By labelling China as state capitalism, the recent political economic literature appears to suggest that the governance of listed SOEs, as the chief embodiment of the Chinese form of state capitalism, has some logic of its own.

Indeed, the nexus between state capitalism and a state-led model of corporate governance is not entirely new to comparative corporate governance researchers. In their 2001 seminal work *The End of History for Corporate Law*, Hansmann and Kraakman famously observed that a state-oriented model of corporate governance existed in post-World War II state-led economies such as France, Japan and some other Asian countries (the ‘former post-war state-led economies’).¹⁵ For these former post-war state-led economies, rather than maximising financial return to shareholders, corporate governance was often an instrument of the state to promote rapid economic development through intervening in the affairs of large companies.¹⁶

Strong support for Hansmann and Kraakman’s observation can be found in the comparative capitalism (or ‘varieties of capitalism’) literature. Particularly, a number of studies have identified state capitalism as a distinct capitalist prototype in addition to the Liberal Market Economies (LMEs, represented by US and the UK) and the Coordinated Market Economies (CMEs, exemplified by Germany and post 1980s

¹¹ Ibid, 69-70.

¹² 胡乐明, 刘志明, 张建刚 [Hu Leming, Liu Zhiming and Zhan Jiangang], ‘国家资本主义与中国模式’[State-capitalism and Chinese Model] (2009) 11 经济研究 *Economic Research* 31, 32-33.

¹³ Nan Lin, ‘Capitalism in China: A Centrally Managed Capitalism (CMC) and Its Future’ (2010) 7 *Management and Organisation Review* 63, 69.

¹⁴ Ibid 68.

¹⁵ Henry Hansmann and Reinier Kraakman, ‘The End of History for Corporate Law’ (2001) 89 *Georgetown Law Journal* 439, 446-7.

¹⁶ Ibid.

Japan).¹⁷ As further illustrated in Chapter 3, put together, these studies have not only shown that corporate governance is an integral component of the institutional mix of a given economic system, but also that state capitalism is associated with a state-led model of corporate governance. Despite considerable country-specific variations, this model, in the former post-war state-led economies, was typically associated with close state-corporate manager relations, the muted voice of minority shareholders and poor protection of other non-shareholder stakeholders except employees whose firm-specific skills were often considered as valuable assets of their companies (the 'former state-led model').

Does this former state-led model, derived from the experiences of the post-war state-led economies, have any application to China? In particular, does it describe the governance of Chinese listed SOEs? On the one hand, this model may have some application to these companies, as suggested by Hansmann.¹⁸ On the other hand, there are some strong forces that propel China to move away from this model. Indeed, as Chapter 8 will illustrate, the dynamic international and domestic challenges faced by Chinese policy makers today are far more pressing than those experienced by the former post-war state-led economies several decades ago.

While state capitalism might be used as an alternative prism to look at governance of Chinese SOEs, it should be noted that state capitalism is not static. Institutional change, including corporate governance change, in state-led economies is shaped by the interaction between the role of the state and international and domestic forces for change, such as economic globalisation and the pluralisation of interests within domestic society. In this respect, the mainstream variety of capitalism (VoC) literature has been criticised for failing to provide a satisfactory account for change.¹⁹ A more

¹⁷ See, eg, Vivien A Schmidt, *The Futures of European Capitalism* (Oxford University Press, 2002)183; Richard Whitley, *Business Systems and Organizational Capabilities: The Institutional Structuring of Competitive Competences* (Oxford University Press, 2007); David Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (Polity Press, 2000); Bruno Amable, *The Diversity of Modern Capitalism* (Oxford University Press, 2003)15. Robert Boyer, 'How and Why Capitalism Differs' (2005) 34 *Economy and Society* 520, 530; Nahee Kang, 'Globalisation and Institutional Change in the State-led Model: The Case of Corporate Governance in South Korea' (2010) 15 *New Political Economy* 519, 521. As will be discussed in Chapter 3, the distinction between Liberal Market Economies and Coordinated Market Economies was first made by Hall and Soskice. See Peter Hall and David Soskice, 'An Introduction to Varieties of Capitalism' in Peter Hall and David Soskice (eds), *Varieties of Capitalism: the Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001) 1.

¹⁸ Henry Hansmann, 'How Close Is the End of History?' (2006) 31 *Journal of Corporate Law* 745, 748.

¹⁹ See, eg, Bob Hancke, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (Oxford University Press, 2007)7; Colin Crouch, *Capitalist Diversity and Change – Recombinant Governance and Institutional Entrepreneurs* (Oxford University Press, 2005) 30-31, Gregory Jackson and Richard Deeg, 'How Many Varieties of Capitalism:

dynamic view has, however, been expressed by Milhaupt and Pistor. In their important 2008 book *Law and Capitalism*, the authors discussed the role of the state and economic changes in changes in law, as a particular type of institution, in legal systems of different organisational features which, in return, correspond to the countries' economic models. In doing so, the authors divided national legal systems into 'centralised systems' which are typically found in countries 'characterised by strong government coordination', ²⁰ and 'decentralised systems' where non-state actors have strong involvement in law making and enforcement. ²¹ These authors envisaged a highly interactive relationship (described by the authors as 'rolling relations') between legal and economic changes in all systems, which usually begin with changes in economic conditions. ²² Economic changes may eventually narrow the scope for state intervention. However, in 'centralised systems', the state may mitigate the impact of economic changes on changes in law by utilising several sets of tools to enhance its coordinating capacity, at least up to a certain point. ²³ As will be discussed in Chapter 3, these include limiting the extent to which the formulation and implementation of law may be contested by private actors, and substitution of demand for law with extra-legal means such as norms.

While not underestimating the above tools, this thesis will shed light on another set of tools that may be utilised by a centralised state to enhance its coordinating capacity. This set is to be found in market forces including mechanisms usually employed in decentralised systems. In the area of corporate governance, this refers to governance mechanisms utilised in advanced market economies and international best practices. The adoption of these tools will inevitably lead to a certain degree of hybridisation in the model of corporate governance previously present in a centralised state. However, it does not necessarily lead to a fundamental systemic transformation.

1.2 Research questions

Using state capitalism and institutional change as an analytical frame, this thesis traces the development of corporate governance law and practice in China in the lead up to

Comparing the Comparative Institutional Analyses of Capitalist Diversity' (MPIFG Discussion Paper No. 06/2, 11 April 2006) 24,37 <<http://ssrn.com/abstract=896384>>.

²⁰ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) 147.

²¹ Ibid 6.

²² Ibid 28.

²³ Ibid 7-8, 38-39.

and after the 2005 corporate law reforms. By critically assessing and interpreting the main changes and continuities thereof, the thesis will answer the following main research question:

Main research question

Does the evolution of law and practice concerning the governance of listed SOEs in China through the 2005 corporate law reforms and the relevant regulatory reforms suggest the emergence of a new model of corporate governance?

While corporate governance is a vast and elastic area, three sets of company relations central to the former state-led model of corporate governance will be considered in this research. As noted earlier, these are: (1) state-manager relations, or state involvement in corporate decision-making and monitoring of managers; (2) legal protection of minority shareholders/investors and (3) legal protection of other corporate stakeholders including employees. Further, a focus on the law and practice relating to these three sets of relations leads to the development of four sets of subsidiary questions which will assist in addressing the main research question:

Subsidiary research questions

1. Why did Chinese policy makers embrace the notion of corporate governance?
What was the concept of corporate governance embraced by them?
2. What were the main features of and problems with corporate governance in listed SOEs prior to the 2005 corporate law reforms?
3. What are the major changes, and continuities, in the regulation of state-managers relations, investor protection and non-shareholder stakeholder protection since the 2005 major corporate law reforms? How can we interpret those changes, and continuities, from the perspective of state capitalism and institutional change?
4. What are the major changes, and/or the lack thereof, in relation to the underlying practice of corporate governance in listed SOEs post-2005? How can we explain the changes and/or the lack thereof?

The answers to these questions are critically important. First, while not ignoring the international and domestic pressures for change, the contextualisation of the governance of listed SOEs in the Chinese state-led model of economic development will deepen our

understanding of the internal logic for corporate governance development in China. Chinese corporate governance has been widely considered as riddled with contradictions. As the review of current research on Chinese corporate governance in Chapter 2 will illustrate, despite increased convergence towards the Anglo-American outsider-based model in formal law, the underlying practice has remained an insider-based system, with state-appointed top corporate managers exercising the real control over the governance process.²⁴ Commentators have so far mainly attributed these contradictions to historical, cultural, political and ideological factors. Given China's long history and its unique cultural and political traditions, these factors will no doubt continue to shape the governance of listed SOEs for a long time, and in many important ways. However, as the opening quote from Bremmer suggests, the recent resurgence of state capitalism in several emerging economic powers, including China, has significantly altered the nature of global competition, as its focus switches from rival political ideologies towards economic models.²⁵ As this competition has been predicted to accelerate,²⁶ the search for alternative underpinnings of Chinese corporate governance, by linking its law and practice to the Chinese state-led economic development strategies, has become important. In other words, if state capitalism and institutional change can serve as an alternative analytical frame, then perhaps some of the arrangements in Chinese corporate governance can be viewed as strategic decisions made by policy makers to facilitate pre-determined goals, rather than simply a manifestation of China's failure to fully engage with the outsider-based governance systems.

Second, if Chinese corporate governance can be seen as a new variant of the former state-led model, this research will contribute to comparative corporate governance literature by providing new evidence of the resilience of state-led corporate governance. The former state-led model, according to Hansmann and Kraakman, has lost most of its intellectual attraction and empirical validity, due to the widespread collapse of state socialism and the stagnation of the East Asian economies since the 1990s.²⁷ In light of

²⁴ On Kit Tam, *The Development of Corporate Governance in China* (Edward Elgar, 1999) 75; Roman Tomasic and Jian Fu, 'Legal Regulation and Corporate Governance in China's Top 100 Listed Companies' (2006) 27 *The Company Lawyer* 278-87; Alice De Jonge, *Corporate Governance and China's H-Share Market* (Edward Elgar, 2008) 82.

²⁵ Bremmer, 'State Capitalism Comes of Age', above 1.

²⁶ National Intelligence Council (U.S.), *Global Trends 2025: A Transformed World* (U.S. Executive Office of the President, 2008) <www.aicpa.org/.../cpahorizons2025/globalforces/.../globaltrends.pdf>.

²⁷ Hansmann and Kraakman, above n 15, 447.

the rethinking of the role of the state in economic development and corporate governance generated by the GFC, the articulation of the model of corporate governance currently employed in China will facilitate a greater recognition of the diversity in international corporate governance systems. Given the fast expansion of SOEs outside China over the past few years, it may further provoke research into the interaction between the Chinese system, and the Western market-based systems of corporate governance.

Third, although located within the realm of legal analysis of corporate governance, this study will also make some contribution to comparative capitalism research. This is because of the interrelatedness of the two spheres. As comparative capitalism suggests, there are varieties of corporate governance systems which support diverse national economic models. The converse is also true. By examining the interrelationship between the Chinese form of state-led capitalism and corporate governance in listed SOEs, this thesis will not only present new evidence of state capitalist practices, but also provide an example of how institutions, particularly corporate governance institutions, may evolve in state capitalism under strong international and domestic pressures for change. To date, this strand of literature has mainly focused on the former post-war state-led economies.

1.3 Research methodology

This study undertakes qualitative research to answer a number of specific questions in relation to governance of state-controlled listed companies in China. In doing so, the study utilises a combination of methods. First, the examination of the official adoption of the concept of corporate governance and the evolution of the corporate governance law and regulation in China will be mainly based on conventional documentary analysis. This involves analysis of primary source materials such as legislation, administrative regulations, voluntary guidelines and policy statements relating to Chinese corporate governance, as well as relevant secondary source materials. Further, as discussed below, a mixture of research methods, including face-to-face interviews, literature review and case study, will be utilised to address the second and fourth sets of subsidiary research questions which concern past and present practices in the governance of Chinese listed SOEs.

1.3.1 Pre-2005 governance practices in listed SOEs: face-to-face interviews

The analysis of corporate governance in Chinese listed SOEs pre-2005 will be primarily based on data collected through a large Australian Research Council (ARC) – funded research project ('ARC project'). The ARC project, carried out during 2002 and 2004, was led by Professors Roman Tomasic and Neil Andrews.²⁸ It investigated a broad range of issues concerning governance of Chinese top 100 listed companies, based on the listing of the top 100 companies published by *Fortune* magazine from 2001 to 2004. A list of these companies, most being state-controlled companies,²⁹ is provided in Appendix 1-1. The primary data from the project has been made available by the chief investigators for use in this thesis.

During the three-year project, 108 face-to-face interviews were conducted with company officers, regulators, corporate law academics and practitioners involved in the governance of the Chinese top 100. A summary of the ARC project interviews by location and type of interviewees is provided in Appendix 1-2. Each interview took between one and two hours.³⁰ A questionnaire of 47 questions covering various aspects of the governance of these large Chinese companies was administered in all interviews. A copy of the project interview schedule is at Appendix 1-3. The interviews were conducted by the two project leaders in English, through an interpreter where an interviewee was a non-English speaker. Interview notes were taken by both project leaders in English. As the Principal Legal Research Officer, this author participated in 25 interviews in December 2004 and was responsible for collation and transcription of all interview data from the entire project.

About 25 questions (marked with an asterisk '*') in the interview schedule are directly relevant to this research. Some of these questions allowed the interviewees to offer personal views on their understanding of the concept of corporate governance, and comment on the levels of importance attached to corporate governance by company directors and officers. Others allowed them to comment on the roles of various internal and external actors and other stakeholders in the governance of Chinese top 100. These

²⁸ A number of articles and one book based on the data have been published by various researchers involved in the ARC project. These include Jia and Tomasic, above n 24; Roman Tomasic and Neil Andrews, 'Minority Shareholder Protection in China's Top 100 Listed Companies' (2007) 97 *Australian Journal of Asian Law* 88; Neil Andrews and Roman Tomasic, 'Directing China's Top 100 Listed Companies: Corporate Governance in an Emerging Market Economy' (2005) 2 *The Corporate Governance Law Review* 245; Tomasic and Jian Fu, above n 24; Roman Tomasic and Jenny Jian Rong Fu, 'Government-owned Companies and Corporate Governance in Australian and China: Beyond Fragmented Governance' (2006) 3 *Corporate Ownership and Control* 123.

²⁹ See further discussion on this point in Chapter 3.

³⁰ Tomasic and Andrews, 'Minority Shareholder Protection in China's Top 100 Listed Companies', above n 28, 95.

include the general meeting, minority shareholders, the board of directors (and the Chairman), the board of supervisors, employees, the regulatory authorities such as the China Securities Regulatory Commission (CSRC), the stock exchanges, courts and the Communist Party (the Party). The interviewees were specifically asked to comment on the impact of the state as a dominant shareholder on corporate governance practices. They were also asked to identify the most important stakeholders in Chinese listed companies. The responses to these questions helped to shed light on the three sets of relations within large listed SOEs prior to the 2005 corporate law reforms. The relevant data have been written up, coded, and summarised in a way to allow the major themes from the interviews to emerge.

1.3.2 Governance practices in listed SOEs post-2005: literature review, informal discussions and case study

A study similar to the ARC project as discussed above would be the best means to investigate governance practice in Chinese listed SOEs following the 2005 corporate law reforms. However, as pointed out by Tomasic, the ARC project might not be replicated now due to the difficulty in eliciting the same degree of cooperation inside China.³¹ Similar to undertaking empirical studies into corporate governance elsewhere, there is always a 'problem of obtaining access to business and other elites for research purposes' in China.³² However, under the current social and political climate in China, an additional obstacle is the enormous public controversy surrounding large SOEs. As Chapter 8 will further illustrate, these companies have become the focus of mounting social tensions associated with the Chinese form of state-led economic development, as their power and wealth expand.

That said, several efforts have been made by this author to update the ARC project interview data. These included reviewing company annual reports and media reports, formal and informal exchanges with a number of Chinese academics, corporate executives, regulatory officers and legal practitioners involved in the governance of listed SOEs. These exchanges took place in various forums over the past few years. The forums included two Australia-China Investment Relations Conferences jointly hosted by University of Canberra and China University of Political Science and Law in 2012

³¹ Conversation with Professor Tomasic on 30 November 2011.

³² Tomasic, 'Looking at Corporate Governance in China's Large Companies', above n 4, 190.

and 2013,³³ and a one-day workshop on corporate governance that this author facilitated in 2011 for a Chinese delegation. The delegation comprised an official from the State-owned Assets Supervision and Administration Commission (SASAC) and 16 senior and mid-level managers from over ten SASAC-administered SOEs. Formal and informal exchanges undertaken in these forums allowed this author to gain substantial inside knowledge on various aspects of governance practices in Chinese listed SOEs.

In addition to information gained from the above avenues, this thesis will utilise several recent studies on Chinese corporate governance, including audit reports issued by the National Audit Office (NAO), to examine governance practice in listed Chinese SOEs post-2005. Most of these studies (except the NAO reports) were based on publicly available information, such as company annual reports and media releases. However, put together, they shed some light on the current state of corporate governance in Chinese listed SOEs.

In the absence of more detailed empirical work, a case study on the Chinese government's involvement in the 2008 milk scandal and its aftermath will be utilised to illustrate the internal working of corporate governance in listed SOEs post-2005. A case study of the milk scandal serves this purpose from several perspectives. First, while a single case study often runs the risk of being unrepresentative, the scandal provides us with rare insight into state involvement in corporate governance at a broad industry scale.³⁴ The scandal caused injury to nearly 300,000 infants, including six deaths.³⁵ Primarily a food incident, it was also a major corporate governance scandal that implicated almost all large and medium-sized producers in the Chinese dairy industry.³⁶ Sanlu, the group of companies at the epicentre of the scandal, was an unlisted privately-controlled corporate group converted from a former SOE. However, a number of other companies implicated in the scandal, including the one that was used by the government to rescue Sanlu, were listed SOEs. Second, due to its large magnitude and profound

³³ The inaugural Australia-China Investment Relations Conference was held in Canberra on 30-31 July 2012. The second conference was held in Beijing on 18 September 2013. The Australian APEC (Asia-Pacific Economic Cooperation) Centre at RMIT, Melbourne also co-hosted the second conference.

³⁴ There have been a small number of case studies on the involvement of the state in the governance of individual companies or group of companies. See, eg, De Jonge, above n 24; Neil Andrews, 'When the CEO Vanished in Spin: Information Disclosure, Corporate Governance and the Bank of China (Hong Kong) Holdings Ltd.' (2004) 17 *Australian Journal of Corporate Law* 71; Milhaupt and Pistor, above n 20, 125-48.

³⁵ 'Two Executed in China over Tainted Milk Scandal' *Xinhua Net News Story* (24 November 2009) <http://news.xinhuanet.com/english/2009-11/24/content_12530798.htm>.

³⁶ 'China Seizes 22 Companies with Contaminated Baby Milk Powder' *Xinhua Net News Story* (17 September 2008) <http://news.xinhuanet.com/english/2008-09/17/content_10046949.htm>.

social, economic and political implications, the scandal also provides a remarkable platform to examine the interaction of state power, corporate governance, and forces of economic globalisation and the rise of interest group politics within Chinese society. Third, as an 'extraordinary event', a corporate scandal may not be representative of the day-to-day governance practices in Chinese companies.³⁷ Nor is it a good illustration of all the positive aspects of China's post-2005 corporate governance reforms. However, as Milhaupt and Pistor pointed out, a study of corporate failures may 'expose features and weakness of a system that were beneath the radar when it was functioning smoothly'.³⁸

Materials on the case study were collected from publicly available information, such as news reports and media releases, which is supplemented by this author's informal discussions with a local judge involved in the bankruptcy of Sanlu and two former Chinese Supreme People's Court judges.

1.4 Main arguments of the thesis

The thesis will argue that China's post-2005 legal and regulatory reforms have not taken the governance of listed SOEs a step closer to the Anglo-American outsider-based model. What has emerged from these reforms is a new state-led model which can be called a 'state-led stakeholder' approach. This approach originated from the Chinese pre-2005 state-led model of corporate governance which, to a large extent, overlapped with the former state-led model. Without the state loosening ultimate control over the affairs of listed SOEs, this approach has, however, significantly shifted away from the former state-led model by taking on a far more measured and inclusive approach. Through drawing upon mechanisms from prevailing international corporate governance models, including the Anglo-American outsider-based/ shareholder model and the broader stakeholder model, China's post-2005 regulation of corporate governance has intensified measures to strengthen monitoring of corporate managers, as well as to improve the protection of minority shareholders and other stakeholders including, but not limited to, company employees. This new state-led model is difficult to reconcile with the Anglo-American outsider-based model. However, it may be explained from the perspective of China's efforts to maintain its state-led economic development, amid strong international and domestic pressures for change faced by Chinese policy makers.

³⁷ Milhaupt and Pistor, above n 20, 10.

³⁸ Milhaupt and Pistor, above n 20, 10-11.

The emergence of this new state-led model has been more evident in China's post-2005 regulatory framework, rather than the reality of corporate governance in listed SOEs. The lack of more radical changes in the latter respect has been, in part, due to various disadvantages associated with the state as essentially the sole guardian of this model. However, as its continued evolution is likely to be incremental at best, the articulation of this model has important implications for our understanding of not only corporate governance in Chinese listed SOEs, but also of comparative corporate governance and comparative capitalism more generally.

It should be noted that, at the time that the draft of this thesis was concluded, China experienced a key power transition. A new generation of leaders, led by President Xi Jinping, has announced its decision to 'comprehensively deepen' the Chinese economic and social reforms.³⁹ However, as will be briefly discussed in Chapters 2, 6 and 8, the various reform tasks outlined by the new leadership have not altered the state-led stakeholder model of corporate governance expounded in this thesis to any significant extent.

1.5 Outline of the thesis

The thesis consists of ten chapters which are divided into three parts. Part One (Chapters 1 to 3) lays the foundation for the study by identifying the rationale, setting out the research questions, research methodology and the theoretical framework. Part Two (Chapters 4 to 9) addresses each set of the subsidiary research questions. Part Three (Chapter 10) concludes the thesis by summarising and reflecting on the main findings. An outline of the thesis is provided as follows.

Chapter 1 introduces the research topic, main research question and subsidiary research question sets. It also sets out the research methodology and methods. This is followed by an outline of the main arguments and the structure of the thesis. Chapter 1 concludes with the definition of the key terms used in this thesis and the thesis cut-off date.

Chapter 2 illustrates the need for a state capitalism and institutional change approach to the governance of listed Chinese SOEs. This is undertaken through identifying the disjuncture between two strands of literature, namely, the Chinese model of economic development and corporate governance in China. In examining the first strand, the

³⁹ 《中共中央关于全面深化改革若干重大问题的决定》 [The Decision on Major Issues Concerning Comprehensively Deepening Reforms], adopted at the Third Plenum of the 18th Central Committee of the Chinese Communist Party, 12 November 2013.

chapter provides an overview of the rise of state capitalism as a characterisation of the Chinese model of economic development. This is followed by a discussion of the key features of this model as suggested in the literature. In reviewing current studies on the governance of listed SOEs, Chapter 2 examines three main analytical approaches employed in this strand of literature. These are the conventional agency theory of the firm-based analysis, path dependence analysis and the interest groups politics approach. The contributions and limitations of studies adopting these three main analytical approaches will also be considered. Chapter 2 then reviews current research that has adopted a state capitalism approach to the study of aspects of Chinese corporate governance and discusses its limitations. The chapter concludes by highlighting the main argument of the chapter.

Chapter 3 sets out the theoretical framework for the research. A state capitalism and institutional change approach to the governance of Chinese listed SOEs post-2005 requires the consideration of three theoretical questions. First, is there a linkage between national systems of corporate governance and national economic development models? If that question can be answered in the affirmative, second, in what ways state capitalism, as a particular model of economic development, shape the system of corporate governance in a given country? And finally, how may the role of the state in a state-led economy shape changes in corporate governance as international and domestic environments evolve? Chapter 3 addresses these questions (and in that order) by drawing upon three interrelated strands of literature. These are comparative capitalism (including the theory of the developmental state), comparative corporate governance, particularly corporate governance in the former post-war state-led economies, and law and capitalism, particularly Milhaupt and Pistor's postulation of the interaction between legal and economic changes within state-led economies and the role of the state in that interaction.⁴⁰

Chapter 4 sets the scene for the analysis of the evolution of corporate governance in Chinese listed SOEs by addressing the first set of subsidiary research questions. To examine the rationale behind China's official adoption of the concept of corporate governance in 1999, Chapter 4 first reviews the two early stages of Chinese SOE reform. The chapter then analyses the actual content of the concept that first appeared in the Party's 1999 *Decision on Several Important Issues Concerning the Reform and*

⁴⁰ Milhaupt and Pistor, above n 20, ch 2.

Development of State-owned Enterprises.⁴¹ The chapter concludes by highlighting the importance of understanding the purpose served by corporate governance in China to the interpretation of legal and regulatory changes concerning the governance of listed SOEs.

Chapter 5 addresses the second set of subsidiary research questions by examining the law and practice concerning governance of large state-controlled listed companies in the lead up to the 2005 corporate law reforms. It first sets the background by providing a brief overview of the Chinese pre-2005 regulatory environment for corporate governance, and the key regulatory and market actors involved in that environment. The chapter then examines China's pre-2005 law and practice concerning state-manager relations, investor protection and other stakeholder (including employees) protection (and in that order) within large listed SOEs. In each section, the main features of the relevant legal and regulatory framework are examined. This is followed by empirical evidence on how the respective framework played out in the reality of corporate governance in China's top 100 listed companies. The various problems underlying the law and practice concerning each set of company relations are also identified and discussed. The chapter concludes by summarising the main findings and their implications for interpreting China's post-2005 corporate governance reforms.

Chapters 6 to 8 address the third set of subsidiary research questions. Through examining and interpreting the changes and continuities in China's post-2005 legal and regulatory reforms of the governance of listed SOEs, the three chapters explore whether the post-2005 framework gives rise to a new model of corporate governance. In doing so, Chapter 6 focuses on the identification of changes, and/or the lack thereof, in China's post-2005 regulation of state-manager relations within listed SOEs, Chapter 7 on investor and other stakeholder protection. As Chapter 7 will discuss, these latter two sets of company relations are often seen as mutually exclusive in the Anglo-American outsider-based model of corporate governance, therefore requiring separate treatments. However, this is not necessarily the case with other corporate governance models. This is particularly so with the former state-led model, where both minority shareholders and non-shareholder stakeholders (excluding employees) were considered company outsiders. As China's pre-2005 regulation of investor and other stakeholder protection

⁴¹ 《中共中央关于国有企业改革和发展若干重大问题的决定》[Decision of the Central Committee of the Chinese Communist Party on Several Major Issues Concerning the Reform and Development of State-owned Enterprises], adopted at the Fourth Plenum of the 15th Central Committee of the Chinese Communist Party, 22 September 1999.

resembled some key features of the former state-led model, a combined discussion of Chinese post-2005 reforms concerning these two sets of company relations will help to illustrate the changes, and continuities, in both aspects. This will also help to illuminate any new corporate governance model that may have emerged from those changes. Chapter 8 interprets changes and continuities in China's post-2005 regulation of corporate governance from the perspective of state capitalism and institutional change.

Chapter 9 addresses the fourth set of subsidiary research questions by examining the impact of China's post-2005 legal and regulatory reforms on the reality of corporate governance in listed SOEs. Drawing upon recent studies on the governance of listed SOEs, Chapter 9 first identifies the changes and continuities in the governance practice in these companies post the 2005 corporate law reforms. To provide some further insight into this area, the chapter also provides a case study of the central and local governments' involvement in the lead up to the 2008 tainted milk scandal and the handling of its aftermath. Chapter 9 then explores the reasons behind the changes, and the lack thereof, in the reality of Chinese corporate governance post-2005. In doing so, this chapter draws upon Ho's analysis of the relative advantages and disadvantages of state-centric corporate social responsibility.⁴² Chapter 9 concludes with a summary of the main findings of the chapter.

Chapter 10 summarises the main findings in previous chapters and reflects on their implications. It begins with a summary of the answers to each set of the subsidiary research questions developed in Chapter 1. It then outlines the contribution of the thesis to Chinese corporate governance, comparative corporate governance and comparative capitalism research more generally. The limitations of the study, and issues for future research, will also be canvassed. Chapter 10 concludes by highlighting the main arguments of the thesis.

1.6 Definition of key terms

State capitalism: The absence of one single uniform definition of this term has been discussed above. In this thesis, the term is used in its broadest sense, namely, a model of economic management and development in which 'the state plays a significant and

⁴² Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375, 431-7.

visible role'.⁴³ The adoption of this broad definition also means that the thesis does not involve itself in the debate whether China is a capitalist or socialist economy.⁴⁴

Corporate governance: Although generally referred to as 'a system by which companies are directed and controlled',⁴⁵ the term also lacks one uniform and precise definition. According to Clarke, the very many definitions of corporate governance generally concern two issues: (1) agency problems between investors and management, i.e., the question of ownership and control and (2) shareholder versus stakeholder theories, that is, for whose interests the corporations should operate.⁴⁶

The definition used in this thesis draws from Williamson who defines corporate governance as the relationship between the firm and its constituencies: labour, capital, suppliers, customers, the community and management.⁴⁷ To that mix of constituencies this thesis adds the state. This definition serves the purpose of this research for two main reasons: its broad coverage of the participants of corporate governance and the non-discriminatory approach it takes to the relevant importance of each of those participants. The broad coverage of this definition, to a certain extent, is also reflected in the definition of corporate governance provided in the *OECD Principles of Corporate Governance*.⁴⁸ The OECD's definition, however, appears to prioritise the relationship between shareholders and managers.

In relation to the definition of 'state,' the Weberian definition, which has been utilised by most developmental state theorists, focuses on non-political party institutions such as bureaucratic, legal and coercive institutions.⁴⁹ However, when the definition is applied to the Chinese context, it must be widened to include the Chinese Communist Party (the

⁴³ Lin, above n 13, 68.

⁴⁴ For this debate, see Peter Nolan, *Transforming China: Globalization, Transition and Development* (Anthem Press, 2004) 45-76.

⁴⁵ *OECD Principles of Corporate Governance* (2004 edition).

⁴⁶ Donald Clarke, 'Nothing but Wind? The Past and Future of Comparative Corporate Governance' (2011) 59 *American Journal of Comparative Law* 75, 79.

⁴⁷ Oliver Williamson, *The Economic Institutions of Capitalism* (New York: The Free Press; London: Collier Macmillan Publishers, 1987) 298.

⁴⁸ The OECD defines corporate governance as '[involving] a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. *OECD Principles of Corporate Governance* (2004 edition).

⁴⁹ Theda Skocpol, 'Bringing the State Back in: Strategies of Analysis in Current Research', in Peter B. Evans, Dietrich Rueschmeyer and Theda Skocpol (eds), *Bringing the State Back in* (Cambridge University Press, 1985) 7; Max Weber M, *Economy and Society* (Bedminster Press, 1968) Vol 1 cited in Christopher Pierson, *The Modern State* (Routledge, 1996)7.

Party). With its governing party position entrenched in the Chinese Constitution, the Party has remained the source of political power in China, and its objectives are carried out through state apparatus such as government departments and the court system.⁵⁰ As demonstrated throughout the thesis, the leading position of the Party in directing the Chinese economic development and transformation has been particularly manifested in the reform of SOEs.

State-controlled companies: In relation to a joint stock company including listed company, the term 'controlling shareholder' is defined in the 2005 Chinese *Company Law* as a shareholder who holds more than 50 per cent of the issued shares in a company, or a shareholder who holds less than 50 per cent of the shares, but whose shareholding in the company is sufficient to allow the shareholder to 'have a vital bearing' on the resolutions of the general meeting.⁵¹ In relation to state-controlled listed companies, the same definition of 'controlling shareholder' is adopted in this thesis. Companies controlled by state-controlled companies are also state-controlled companies.

Stakeholder: Edward Freeman, a pioneer in the development of stakeholder theory, defines stakeholders as 'those groups who have a stake in or claim on the firm' which 'include suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups'.⁵² This broad notion of corporate stakeholders is adopted in a number of authoritative codes and guidelines including the *Australian Standard on Corporate Social Responsibility* (AS 8003-2003).⁵³ It should be noted that in legal analysis of corporate governance, shareholders, including minority shareholders, are not usually grouped with stakeholders. This is because of the way that corporate law constructs power relationships between the shareholders and directors as insiders and stakeholders as outsiders.⁵⁴ The broad notion

⁵⁰ 《中华人民共和国宪法》 [Constitution of the People's Republic of China] Preamble. For the relationship between the Party and the state organisation under Chinese constitutionalism, see Larry Cata Backer, 'Party, People, Government and State: On Constitutional Values and the Legitimacy of the Chinese State-Party Rule of Law System' (2012) 30 *Boston University International Law Journal* 331.

⁵¹ 2005 *PRC Company Law* art 217 (2).

⁵² Edward Freeman, 'Stakeholder Theory of the Modern Corporation', in T. Donaldson and P. Werhane (eds.), *Ethical Issues in Business: A Philosophical Approach* (Prentice Hall, Englewood Cliffs, 2002, 7th ed) 38, 39. This broad definition is also followed by some other authors. See, eg, Bryan Horrgan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar Publishing, 2010) 44.

⁵³ Horrgan, above n 52.

⁵⁴ Indeed, while shareholder and stakeholder groups are not necessarily dichotomous, most corporate governance theorists tend to include shareholders in their discussion of corporate governance but not stakeholders.

of stakeholders is, however, adopted in this thesis. As Chapter 8 will discuss, this broad notion is also reflected in a number of Chinese regulatory documents on corporate social responsibility.

Institutions: This term is defined by Douglass North as ‘the rules of the game of a society, or more formally...the human devised constraints that structure human interaction. In consequence they structure incentives in human exchange, whether political, social or economic’.⁵⁵ According to North, this definition has three elements, formal written rules such as statute law, common law and regulations, informal rules such as conventions, norms of behaviour and voluntary codes of conduct, and the effectiveness of related enforcement mechanisms.⁵⁶ North also distinguishes institutions from organisations which are ‘groups of individuals’ (such as political, social or educational bodies) ‘bound by a common purpose to achieve objectives’.⁵⁷ Therefore, organisations are not institutions, although they operate under the institutional framework of a society and also create their own formal and informal rules.⁵⁸ North’s definitions of institutions and organisations are also followed by comparative capitalism theories such as Hall and Soskice, although the latter’s definition of institutions appears to have ignored the quality of enforcement of formal and informal rules.⁵⁹ Based on North’s definition, the central focus of this thesis is the Chinese statutory law, regulations and policy statements, and their implementation; concerning the three sets of company relations examined in this research.

1.7 Cut-off date

The laws and regulations referenced in this thesis are current as of 20 January 2014.

⁵⁵ Douglass North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press, 1990) 3.

⁵⁶ Ibid 3-4.

⁵⁷ Ibid 5.

⁵⁸ Natalia Boliari and Kudret Topyan, ‘Conceptualizing Institutions and Organizations: A Critical Approach’ (2007) 5 *Journal of Business and Economic Research* 1, 3.

⁵⁹ Hall and Soskice define institutions as ‘a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive or material reasons’, and organisations as ‘durable entities with formally recognised members, whose rules also contribute to the institutions of the political economy’. See Hall and Soskice, above n 17, 9.

CHAPTER 2 LITERATURE REVIEW

2.1 Introduction

This chapter illustrates the need for a state capitalism and institutional change approach to the governance of listed state-owned enterprises (SOEs) in China by highlighting the gap between two growing strands of literature: namely, studies of the Chinese form of state capitalism and corporate governance. In doing so, this chapter will show that despite the proliferation of analytical approaches, the main approaches adopted in the study of Chinese corporate governance have not contextualised the governance of listed SOEs within China's state-led model of economic development. Although a small number of studies have begun to do so, they suffer from several important limitations due, in part, to their piecemeal nature. A systemic and in-depth analysis of the evolution of the law and practice concerning corporate governance in these companies, through the lens of state capitalism and institutional change, has remained absent.

The remainder of this chapter is divided into three sections. In examining current research on the Chinese state-led capitalism, section 2.2 first reviews the rise of state capitalism as a characterisation of the model of economic management and development employed in China. This is followed by a discussion of the key features of this model as identified in the literature. Section 2.3 reviews current studies on Chinese corporate governance, particularly corporate governance in listed SOEs. It first examines the three main analytical approaches adopted in this strand of literature. These are the conventional agency theory of the firm, path dependence analysis and the interest groups politics approach. The contributions and limitation of these three analytical approaches to the understanding of Chinese corporate governance will also be considered. The section then reviews current studies that have adopted a state capitalism approach to the study of aspects of corporate governance in listed SOEs and identifies their limitations. Section 2.4 concludes by highlighting the main argument of this chapter.

2.2 Current research on state capitalism in China

With China's double-digit growth over the past three decades, the Chinese model of economic management and development has captured worldwide attention. In the political economic literature in the 1980s and 1990s, the Chinese model was typically described as an incremental approach, which is in contrast to the various 'big bang'

strategies adopted by the former Soviet Union and East European countries in their transformation from a planned state to market economy. This approach denotes the gradual, sequenced and step-by-step withdrawal of the state from various spheres of the economy, with the parallel introduction of market forces including the private sector.¹ As Naughton observed, 'the economy gradually grew out of the plan, as both the plan itself and the state sector as a whole became less dominant elements in the economy as a whole'.² However, there have been some strong signs of change in the literature since the mid-2000s.

2.2.1 State capitalism as a characterisation of the Chinese economic development model

As noted in Chapter 1, instead of being a keen follower of market capitalism, China has been increasingly viewed as 'state-led capitalism', or its short form 'state capitalism', in recent political economic literature.³ Indeed, a special issue of the *Economist* magazine in 2012 named China as a leading example of this growing phenomenon among developing economies, including Russia and Brazil.⁴

The Chinese form of state capitalism has been expressed by Western researchers in different terms, such as 'state-directed capitalism',⁵ 'centrally-managed capitalism',⁶ 'developmental state'⁷ or 'new mercantilism'.⁸ Despite their nuanced differences, the various taxonomies highlight a system that bears some resemblance to the post-war

¹ Minxin Pei, *China's Trapped Transition: the Limits of Developmental Autocracy* (Harvard University Press, 2006) 25-27. For an account of the Chinese gradualist reforms in its early reform stages, see Barry Naughton, *Growing out of the Plan: Chinese Economic Reform, 1978-1993* (Cambridge University Press, 1996); Barry Naughton, *The Chinese Economy: Transitions and Growth* (The MIT Press, 2007).

² Naughton, *Growing out of the Plan: Chinese Economic Reform*, above n 1, 13.

³ Derek Bacon, 'Emerging-market Multinationals: The Rise of State Capitalism' *The Economist* (online) (21 January 2012) <<http://www.economist.com/node/21542930>>; Ian Bremmer, *The End of the Free Market: Who Wins the War between States and Corporations?* (Portfolio, 2010) 129; G. John Ikenberry, 'The Future of the Liberal World Order', (2011) 90 *Foreign Affairs* 56, 57; Barry Naughton, 'The Transformation of the State Sector: SASAC, the Market Economy and the New National Champions' in Barry Naughton and Kellee Tsai (eds) *China's State Capitalism: Growth and Crisis* (Cambridge University Press, forthcoming) <www.cctr.ust.hk/materials/.../Naughton-SASAC-paper-20110824.doc>.

⁴ Bacon, above n 3.

⁵ Stefan Halper, *The Beijing Consensus* (Basic Books, 2010) 113; Yasheng Huang, *Capitalism with the Chinese Characteristics* (Cambridge University Press) xvii.

⁶ Nan Lin, 'Capitalism in China: A Centrally Managed Capitalism (CMC) and Its Future' (2010) 7 *Management and Organisation Review* 63.

⁷ Gordon White 'Developmental States and Socialist Industrialisation in the Third World' (1984) 21 *Journal of Development Studies* 97; Gordon White and Robert Wade, 'Developmental States and Markets in East Asia: An Introduction', in Gordon White (ed), *Developmental States in East Asia* (Macmillan Press, 1988)1; Phil Deans, 'The People's Republic of China: The Post-Socialist Developmental State' in Linda Low (ed), *Developmental States: Relevancy, Redundancy or Reconfiguration?* (Nova Science, 2004) 133; Alvin Y. So, 'Introduction' in (2002) 35 *The Chinese Economy* 3, 5.

⁸ Jonathan Holslag, 'China's New Mercantilism in Central Africa' (2006) 5 *African and Asian Studies* 133.

state-led economies such as Japan, South Korea, Taiwan and France prior to the late 1980s. As will be further discussed in Chapter 3, the state played a leading role in promoting economic growth through association with or intervention in businesses, especially large businesses, in those economies.⁹

Another taxonomy concerning the Chinese economic development model, that has gained increasing appeal among Chinese scholars, is 'the China Model'. It is widely believed that this taxonomy was derived from the 'Beijing Consensus' (as opposed to 'Washington Consensus'), a term coined by Ramo who recommended the Chinese model as an alternative for the third world.¹⁰ Some scholars inside China have used 'state capitalism' to describe the Chinese form of state-led economic development.¹¹ However, many others have used the term 'the China model' instead,¹² as they see 'state capitalism' as a contradiction in ideology with 'socialism with Chinese characteristics', the official expression for the unique path to socioeconomic development adopted in China. First put forward by Deng Xiaoping in 1982,¹³ the term 'socialism with Chinese characteristics' has been generally interpreted as 'grounding in the Chinese indigenous conditions, but utilising all mechanisms available (including mechanisms of capitalism) to achieve economic development and socialist modernisation'.¹⁴

Different Chinese scholars have defined 'the China model' and described its features in different ways. The term is generally considered a very broad notion that entails a distinctive set of theories, systems and practices which span political, economic, social and cultural spheres, and have been the key to the remarkable economic success

⁹ Nan Lin, above n 6, 69.

¹⁰ Joshua Ramo, *The Beijing consensus* (London: Foreign Policy Centre, 2004).

¹¹ 胡乐明, 刘志明, 张建刚 [Hu Leming, Liu Zhiming and Zhan Jiangang], '国家资本主义与中国模式' [State-capitalism and Chinese Model] (2009) 11 经济研究 *Economic Research* 31, 33.

¹² According to Fang, a search of the CNKI (China Knowledge Resource Integrated Database), a leading database on Chinese journal articles, found that 194 papers published in 2009, and 319 in 2010, contain the phrase 'the China model' in their titles. See 刘芳 [Liu Fang], '“中国模式”研究热点解析' [Hot Issues of Research on the 'China Model'] (2013) 1 北京行政学院学报 *Journal of Beijing Administrative College* 55, 58.

¹³ 刘志明 [Liu Zhiming], '中国模式不是国家资本主义' ['China Model' is not State Capitalism] (2009) 15 红旗文稿 *Red Flag Manuscript* 11, 14; 秦宣 [Qin Xuan], '国际视野中的“中国模式”——兼论中国特色社会主义的国际影响' [International Perspective of the China Model---Also on the Socialism with Chinese Characteristics and its International Influence] (2008) 4 中国人民大学学报 *Journal of Renmin University of China* 9, 9-10; 齐冰 [Qi Bing], '当前关于中国模式的研究述评' [Current Research on 'China Model'] (2009) 3 理论导刊 *Journal of Socialist Theory Guide*. The term 'socialism with Chinese characteristics' was first used by Deng Xiaoping at the 12th National Congress of the Chinese Communist Party in 1982.

¹⁴ 齐冰 [Qi Bing], above n 13; See also 秦宣 [Qinxuan], '对中国特色社会主义的理性思考' [Some Thoughts on Socialism with Chinese Characteristics] (2005) 2 中国特色社会主义研究 *Socialism with Chinese Characteristics Research* 5, 9. 刘志明 [Liu Zhiming], above n 13.

achieved by China over the past few decades.¹⁵ The capitalism versus socialism ideological debate aside, most researchers who subscribe to the notion of 'the China model', however, recognise two basic features of the Chinese form of state capitalism outlined below.

There have been different views concerning the timing of the emergence of state capitalism in China. Huang argued that state capitalism began to emerge in China in the early 1990s, where the Chinese reform strategy shifted away from a bottom-up approach with a focus on rural reform and private entrepreneurship, to a top-down one that focused on the capacity building of the central government and development of large SOEs in urban areas.¹⁶ The bottom-up pattern of economic reform in the 1980s was generally considered as having 'run its course' by 1993,¹⁷ as despite high economic growth, the pattern generated problems such as overheating, runaway inflation and the declining capacity of the central government to maintain macro-control over the economy.¹⁸ Prudent re-centralisation was regarded as necessary to carry out the tougher institutional reforms in key economic areas, including institutional reform of SOEs.¹⁹

For Naughton, the rise of the Chinese form of state capitalism was, however, best evidenced in the emergence of 'a distinctive industrial system' dominated by large and profitable central government-affiliated SOEs ('central SOEs', often referred to as the 'national champions' in the literature).²⁰ This phenomenon did not occur until the establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003 to consolidate state power over the then nearly 200 central SOEs. At the 16th National Congress of the Chinese Communist Party (the Party) in late 2002, the Party put forward two guiding principles for further reforming management of state-owned assets in industrial and commercial SOEs. The first was the separation of state investor functions among different levels of government to 'give full play to the

¹⁵ 赵凌云, 赵红星 [Zhao lingyun, Zhao Hongxing], '论中国模式的人类思想史意义' [The Implications of the 'China Model' to the History of Human Thoughts] (2011)5 湖北社会科学 *Hubei Social Science* 5; 刘芳 [Liu Fang], above n 12.

¹⁶ Huang, above n 5, 168-9.

¹⁷ Naughton, *The Chinese Economy*, above n 1, 90.

¹⁸ Tony Saich, *Governance and Politics of China* (Palgrave Macmillan, 2nd ed, 2004) 243; Tianbiao Zhu, 'Building Institutional capacity for China's New Economic Opening', in Linda Weiss (ed), *States in the Globalisation: Bringing domestic Institutions Back in* (Cambridge University Press, 2003) 142, 147-8;

¹⁹ Naughton, *The Chinese Economy*, above n 1, 100; Saich, above n 18, 243.

²⁰ Naughton, 'The Transformation of the State Sector', above n 3:

initiative of both the central and local authorities'.²¹ Hence, the central government would forthwith retain its state investor functions over SOEs that 'have bearing on the national economic lifeline and state security and enterprises in such fields as important infrastructures and natural resources'²² and hand over all other enterprises, usually the less strategic or less profitable ones, to governments at provincial and municipal levels. Second, a state-owned assets supervision and administration agency was to be established at each government level to centralise the management of state-owned assets in commercial entities, and to provide a leading government agency to further reform the state sector. Consequently, SASAC was established under the State Council to exercise central government ownership role over the then 196 large SOEs previously controlled by various ministries. For enterprises in the financial sector that fell outside SASAC's purview, Central Huijin Investment Limited (which was merged into China Investment Corporation, China's largest sovereign invest fund in 2007) was established to hold state shares in major financial institutions including the four largest Chinese commercial banks. As discussed in Chapter 6, within a few years, SASAC has emerged as a strong government regulator through taking over many powers from other government departments as well as being granted some new ones by the State Council.²³

Of course, there are other taxonomies of the Chinese model of economic development. For example, political scientists such as Oi and Schortgen argued that the Chinese state can be best described as 'local state corporatism' or a 'decentralised developmental state' in contrast to the uniform top-down 'developmental state'.²⁴ For these authors, although the central government still retains a certain degree of control over the key sectors and core enterprises, local governments have gained substantial autonomy over local development strategies. Indeed, alongside an emerging state capitalist account of the close relations among central government departments, state-owned banks and the

²¹ Full Text of Jiang Zemin's Report at the 16th Congress of the Chinese Communist Party (18 November 2002) <http://english.people.com.cn/200211/18/eng20021118_106983.shtml>.

²² 《中华人民共和国企业国有资产法》 [Law of Enterprise State-owned Assets of the People's Republic of China] (People's Republic of China) National People's Congress, 28 October 2008, art 4.

²³ Such as powers to appoint certain corporate executives, to collect dividends from central SOEs and to approve their budgets and major investment plans.

²⁴ Jean Oi, 'The Role of the Local State in China's Transitional Economy' (1995) 144 *The China Quarterly* 1132, 1132; Francis Schortgen, 'A Contextual View of Chinese Enterprise Internationalisation' in Ilan Alon et al (ed), *China Rules: Globalization and Political Transformation* (Palgrave Macmillan, 2009) 15.

large SOEs,²⁵ there has been a growing body of literature documenting state-business cooperation at local levels.²⁶ In this literature, local officials have been perceived as standing 'at the forefront of establishing symbiotic interactions with private firms and undertaking direct developmental interventions'.²⁷ This is despite the fact that strong local initiatives have at times tended to limit the reach of central government policies. This is particularly where the interests of local governments conflict with those of the central state.²⁸ In a less positive appraisal, Pei argued that the Chinese model has devolved from a developmental state to a 'decentralised predator state', due to ever increasing decentralisation of state power coupled with rampant rent-seeking and corruption at local levels.²⁹ Furthermore, the diverse political, economic and cultural factors that shape the Chinese political economy at its central and local levels have led McNally to postulate the emergence of a hybrid form of capitalism in China. It combines state-led capitalist development from the top with 'network capitalism' (clusters of small businesses based on family or *Guanxi* ties) in the Chinese fast growing private sector, but is also influenced by the world capitalist system represented by the US and Britain.³⁰

However, most of these alternative taxonomies outlined above do not contradict the leading role played by the central state in the overall Chinese economy. As McNally stated, '[u]nmistakably, China's industrial capitalism remains heavily shaped by the hand of the state'.³¹ Indeed, as will be shown in Chapter 9, local officials' obsession with high local economic growth has, to a large extent, been generated by strong incentives provided by the central government.

²⁵ Larry Cata Backer, 'Sovereign investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience' (2010) 19 *Transnational Law & Contemporary Problems* 3; Ronald Gilson and Curtis Milhaupt, 'Economically Benevolent Dictators: Lessons for Developing Democracies' (2011) 59 *American Journal of Comparative Law* 227-288; Barry Naughton, 'China's Distinctive System: Can it be a Model for Others?' (2010) 19 *Journal of Contemporary China* 437.

²⁶ Alexius A. Pereira, *State Collaboration and development Strategies in China: The Case of China-Singapore Suzhou Industrial Park* (1992-2002) (RoutledgeCurzon, 2003); Andrew Walder, 'Local governments as Industrial Firms: An Organizational Analysis of China's Transitional Economy' (1995) 101 *American Journal of Sociology* 263; Jean Oi, above n 24; Jane Duckett, *The Entrepreneurial State in China: Real Estate and Commerce Departments in Reform Era Tianjin* (Routledge, 1998); Barbara Krug and Hans Hendrichske, 'Framing China: Transformation and Institutional Change through Co-evolution' (2008) 4 *Management and Organization Review* 81.

²⁷ Christopher A. McNally, 'The Institutional Contours of China's Emergent Capitalism' in Christopher A. McNally (ed) *China's Emergent Political Economy: Capitalism in the Dragon's Lair* (Routledge, 2008) 105, 118.

²⁸ Ibid 117-8.

²⁹ Pei, above n 1, 132-3.

³⁰ McNally, above n 27, 107-20.

³¹ Ibid, 116.

2.2.2 Key features of the Chinese form of state capitalism

Although all forms of state capitalism entail a leading role of the state in economic management and development, the Chinese form may be distinguished from the former post-war state-led economies in two important aspects. As Chapter 8 will illustrate, both aspects have shaped China's legal and regulatory reforms of the governance of listed SOEs post-2005.

The first is the large size and scale of state ownership of large enterprises.³² According to Professor Wang Yong, Chinese SOEs serve three main functions. First, they have a monopoly over fundamental resources and key economic sectors on behalf of the state. Second, they help to channel large volumes of state investments upon which the economy relies for development. And third, they provide an important source of funding for various formal and informal operations of state bureaucracies.³³

State ownership of enterprises was also present in some former post-war state-led economies such as France and Taiwan.³⁴ The size and scale of state ownership in China is, however, unprecedented. Despite successive waves of corporatisation and diversification of state shares since the early 1990s, there were 144,700 state-owned or state-controlled enterprises (excluding enterprises in the financial sector) in China by the end of 2011.³⁵ SOEs, especially central SOEs, have continued to dominate sectors considered by the state as 'strategic' or 'pillar industries'. These include, but are not limited to, energy and resources, finance, telecommunications, transportation, machinery and information and technology.³⁶

³² Huang, above n 5, 278-81; 郑永年 [Zheng Yongnian], '国际发展格局中的中国模式' [The Chinese Model of Development: An International Perspective] (2009) 5 中国社会科学 *Chinese Social Science* 20; 赵凌云, 赵红星 [Zhao lingyun, Zhao Hongxing], above n 15; 刘芳 [Liu Fang], above n 12, 56.

³³ Wang Yong, 'Progress on SOEs Means Answering Political Questions' *Caixin Magazine (online)* (22 May 2013) <<http://english.caixin.com/2013-05-22/100531336.html>>.

³⁴ Neil and Fligstein and Jianjun Zhang, 'A New Agenda for Research on the Trajectory of Chinese Capitalism' (2011) 7 *Management and Organization Review* 39, 51; McNally, above n 27, 116.

³⁵ 王勇 [Wang Yong], '国务院关于国有企业改革与发展工作情况的报告' [Report of the State Council on State-owned Enterprises Reform and Development] (Delivered at the 29th Meeting of the National People's Congress Standing Committee, 24 October 2012) <http://www.npc.gov.cn/npc/xinwen/2012-10/26/content_1740994.htm>.

³⁶ According to a list released by the State Council in 2006, seven sectors are considered as strategically important and therefore the state should maintain full or absolute control. These are defence, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation and shipping. Several other industries are designated as 'basic and pillar industries' in which the state should maintain absolute or relative controlling stake. These industries, often considered as competitive businesses in the West, include: machinery, automobile, information technology, construction, steel, basic metals, chemicals, land surveying and research and development. See Mikael Mattlin, 'The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-owned Enterprises' (Bank of Finland, Institute for Economics in Transition, BOFIT Discussion Paper No 10/2007, October 2007) 16 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1001617>.

The dominance of state ownership is also reflected on the Chinese stock market. By the end of 2012, state-controlled companies accounted for 38.5 per cent of the around 1700 companies listed on the Chinese stock market, and over 50 per cent of the total market capitalisation.³⁷ A proportionally large listed company is more likely to be controlled by the state. In 2012, the combined capitalisation of the Chinese top 100 accounted for about 60 per cent of the total market capitalisation of all listed companies in China.³⁸ Eighty-four of these companies had the state, often in the form of a wholly state-owned parent SOE, as their largest shareholder.³⁹ A list of China's top 100 listed companies in 2012, ranked by market capitalisation, is at Appendix 2-1.

There has been little sign of state withdrawal from large and strategic listed SOEs. This is despite that the new Chinese leadership has announced its intention to diversify ownership in wholly-state owned enterprises. As noted in Chapter 1, at the Third Plenum of the 18th Party Congress in November 2013, China's new President Xi Jinping outlined the Party's vision for 'comprehensively deepening reforms'.⁴⁰ Xi pointed out that further reform should enable markets to play 'a decisive role' in allocation of resources (although the role of the government in microeconomic control should also be strengthened). As will be discussed in Chapter 6, in relation to the continuing reform of the state sector, a number of market-oriented strategies have been announced by Xi. These include further promotion of the concentration of state-owned capital in 'major industries and key areas relating to national security and national economic lifelines'⁴¹ and encouraging 'mixed ownership' in wholly state-owned enterprises (except those vital to 'national security') by introducing private investments. However, similar to his predecessor Hu Jintao, Xi stressed that public ownership should

³⁷ '国资委：加快大型国企整体上市步伐' [SASAC: Speed up Full Listing of Large State-controlled Enterprises], *China Net News Story* (11 January 2013) <<http://finance.china.com.cn/stock/zqyw/20130111/1231788.shtml>>.

³⁸ Protiviti and Chinese Academy of Social Science, 《2012 中国上市公司一百强治理评价报告》 [Corporate Governance of Chinese top 100 Chinese listed companies 2012 Report] 2 <<http://www.protiviti.com/zh-CN/Pages/zh-CN-Corporate-Governance-Assessment-Summary-Report-on-the-Top-100-Chinese-Listed-Companies.aspx>>.

³⁹ Ibid 11.

⁴⁰ 《中共中央关于全面深化改革若干重大问题的决定》 [Decision on Several Major Issues Concerning Comprehensively Deepening Reforms], adopted at the Third Plenum of the 18th Central Committee of the Chinese Communist Party, 12 November 2013 ('*Decision on Deepening Reforms*').

⁴¹ The principle of focusing state-owned capital on 'major industries and key areas relating to national security and national economic lifelines' was first put forward by the Party in 1999. These industries include industries relating to national security, natural monopoly industries, industries providing public products and services, pillar industries and key enterprises in high-and-new-technology industries. See 《中共中央关于国有企业改革和发展若干重大问题的决定》 [Decision of the Central Committee of the Chinese Communist Party on Several Major Issues Concerning the Reform and Development of State-owned Enterprises], Adopted at the Fourth Plenum of the 15th Central Committee of the Chinese Communist Party, 22 September 1999.

remain the mainstay of China's socialist market economy, and that the Party should 'unwaveringly consolidate and develop the public sector' to 'enhance its vitality' and 'capacity to leverage and influence the economy'.⁴² These pronouncements are consistent with the Chinese 12th *Five-year Plan for National Economic and Social Development* (2011-2015) which includes the following objectives: to improve the strength and quality of central SOEs and foster them into 'internationally competitive and world top class enterprises'.⁴³

Recent literature has also highlighted a second feature of the Chinese form of state capitalism that distinguishes China from the former Soviet style planning state. This is the remarkable ability of the Party-state to combine state power with market-based means to achieve policy goals.⁴⁴ Indeed, this feature has led Bremmer to define state capitalism as 'a system in which the state functions as the leading economic actor and uses markets primarily for political gain'.⁴⁵ In his examination of the unique features of China's industrial system, Barry Naughton showed that:

[t]he Chinese model ... combines two characteristics that are not normally regarded as bedfellows. Firstly, there is a ubiquitous (and pluralistic) state, which is highly active and involved in multifarious ways in the economy (and society). Secondly, there is a powerful commitment to the market and a very strong belief in competition.⁴⁶

The combination of state planning and market forces has been viewed by many scholars as the greatest innovation of the 'China model', as it bridges the divide between the state and market as two mutually exclusive spheres in neoliberal economics.⁴⁷ For many Chinese scholars, this flexible adaptability and creativity of 'the China model' finds its full expression in 'socialism with Chinese characteristics'.⁴⁸

⁴² *Decision on Deepening Reforms*, above n 40. Full text of Hu Jintao's Report at the 18th Congress of the Chinese Communist Party (17 November 2012) <http://news.xinhuanet.com/english/special/18cpcnc/2012-11/17/c_131981259.htm>.

⁴³ 《中华人民共和国国民经济和社会发展第十二个五年规划纲要》 [Outline of the Twelfth Five-year Plan on National Economic and Social Development], adopted at the Fourth Plenum of the 11th National People's Congress, 16 March 2011.

⁴⁴ Bremmer, *The End of the Free Market*, above n 3, 23; 郑永年 [Zheng Yongnian], above n 32; 张维为 [Zhang Weiwei], '一个奇迹的剖析: 中国模式及其意义' (2011) 6 红旗文稿 *Red Flag Manuscript* 4, 6.

⁴⁵ Ian Bremmer, 'State Capitalism Comes of Age' (2009) 88 *Foreign Affairs* 40, 41.

⁴⁶ Martin Jacques, 'How China Will Change the Way We Think: The Case of the State' (Transatlantic Academy Paper Series, February 2011) 4 <<http://www.transatlanticacademy.org/publications/how-china-will-change-way-we-think-the-case-state>>; Naughton, 'China's Distinctive System: Can it be a Model for Others?', above n 25.

⁴⁷ See, eg. Halper, above n 5, xiii; 张建君 [Zhang Jianjun], '中国模式的转型逻辑与理论创新' [The Transition Logic and Theoretical Innovation of the 'China Model'] (2008) 10 社会科学战线 *Social Science Front* 82.

⁴⁸ 刘芳 [Liu Fang], above n 12; 秦宣 [Qinxuan], above n 14.

Some commentators also believe that this second feature of the Chinese economic model is built on China's unique political system, that is, an authoritarian but growth-favouring government under the Party's leadership.⁴⁹ Zheng Yongnian argued that political systems serve different objectives in different countries. Rather than promoting democracy, the current political arrangements in China are geared towards maintaining social and economic conditions (such as social stability, the protection of property rights and social justice) necessary for economic reform and development.⁵⁰ For commentators such as Zhang Weiwei and Pan Wei, this system is deeply rooted in China's ancient history and the traditional Chinese preference for a strong government to guide national development and maintain social order.⁵¹ As Chapters 6 and 7 will demonstrate, the remarkable ability of the Chinese state in combining state power with market forces has underlined China's post-2005 legal and regulatory reforms of corporate governance in listed SOEs.

This chapter has so far considered the rise of state capitalism as a characterisation of the Chinese model of economic development. Chapter 8 will discuss the increasing challenges faced by China's policy makers in maintaining this model, due to globalisation of markets and the pluralisation of interests within Chinese society. As examined next, despite the proliferation of analytical approaches to Chinese corporate governance, a systemic and in-depth investigation of the law and practice concerning the governance of listed SOEs from the perspective of comparative capitalism and institutional change has remained largely absent.

2.3 Current research on corporate governance in China

Despite its short history,⁵² Chinese corporate governance, especially governance of listed SOEs, has generated enormous attention both within and outside the country.

⁴⁹ 胡键 [Hu Jian], '争论中的中国模式: 内涵, 特点和意义' [China Model in Debates: Contents, Characteristics and Significance] (2010) 6 社会科学 *Social Science* 3, 7-8; 郑永年 [Zheng Yongnian], '中国模式的核心是什么?' (2010) 12 社会观察 *Social Observation* 87, 88.

⁵⁰ 郑永年 [Zheng Yongnian], '国际发展格局中的中国模式', above n 32, 22-23.

⁵¹ 张维为 [Zhang Weiwei], above n 44, 6-7; 潘维 [Pan wei] '中国模式- 中华体制的经济政治社会解析' ['China Model': An analysis of the Chinese Economic, Political and Social System] (2009) 5 北京大学中国与世界研究中心研究报 *Research Reports of the Beijing University China and the World Centre*, 5

⁵² As will be further discussed in Chapter 4, China did not commence large scale corporatisation and listing of SOEs until the early 1990s, and the concept of corporate governance was officially introduced into China only in 1999 at the Fourth Plenum of the 15th Party Congress.

Three main analytical approaches, which significantly overlap with each other, may be identified from a rapidly growing body of literature.⁵³

2.3.1 Agency theory of the firm-based analysis

As the study of corporate governance is centrally concerned with whether a particular form of corporate governance would better promote company performance than other forms, economic theories of the firm have traditionally dominated comparative analysis of national systems of corporate governance.⁵⁴ Two broad strands of scholarship have informed this analysis, namely, agency theory and transaction cost economics.⁵⁵ Of these two strands, agency theory has served as 'the dominant force in the theoretical understanding of corporate governance' around the world.⁵⁶ This is associated with the strong economic performance of the Anglo-American outsider-based model of corporate governance since the late 1990s.

Agency theory was developed by Jensen and Meckling to address problems of corporate governance associated with separation of ownership and control, a widespread phenomenon in Anglo-American modern large corporations which was first observed by Berle and Means.⁵⁷ The contractual theory of the firm views a company as a nexus of contracts among different resource holders such as investors and managers.⁵⁸ Jensen and Meckling extended this analysis by describing the relationship between the investors and managers as an agency relationship and articulating the motivational divergence between them. The self-seeking shareholders, as principals, incur agency

⁵³ Of course there are other approaches to the Chinese corporate governance. For example, in a recent study on Chinese corporate governance, Chen applied an institutional analysis by drawing upon new institutional economics. In doing so, she focused on the interaction between various governance mechanisms and its impact on corporate governance enforcement and the development of the stock market in China. See Ding Chen, *Corporate Governance, Enforcement and Financial Development: The Chinese Experience* (Edward Elgar, 2013).

⁵⁴ Thomas Clarke, 'Introduction: Theories of Governance- Reconceptualising Corporate Governance Theory after the Enron Experience' in Thomas Clarke (ed), *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* (Routledge, 2004) 1, 7; Also see William Bratton and Joseph Macahery, 'Comparative Corporate Governance and the Theory of the Firm: the Case Against Global Cross-Reference' (1999) 38 *Columbia Journal of Transnational Law* 213, 235; Neil Fligstein and Jennifer Choo, 'Law and Corporate Governance' (2005) 1 *Annual Review of Law and Social Science* 61, 6.

⁵⁵ Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australian* (the Federation Press, 2nd ed, 2002) 56.

⁵⁶ Thomas Clarke, 'Introduction' above n 54, 4; Also see Donald Clarke, 'Nothing But Wind? The Past and Future of Comparative Corporate Governance' (2011) 59 *American Journal of Comparative Law* 75, 84.

⁵⁷ Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property* (Transaction Publishers, 1932); Michael C Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305; Also see Eugene Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 *Journal of Political Economy* 228; Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301.

⁵⁸ Jensen and Meckling, above n 57, 310-31.

costs in supervising the managers (agents) who, motivated by their own interests, may not always act in the best interests of the shareholders.⁵⁹ The main task of corporate governance is therefore to minimise agency costs by providing mechanisms that can substitute for investor monitoring.⁶⁰ Thus, a wide range of internal mechanisms (such as mandatory disclosure of information, independent directors and executive remuneration) have been suggested by various researchers to complement the external mechanisms (such as market for corporate control, labour market and outsider participation).⁶¹ The rise of institutional investors since the late 1990s has also been seen as an important mechanism of corporate governance.⁶²

In addition to the agency problem between the shareholders and managers, recent agency analysis of corporate governance has discussed a second agency problem, namely the potential exploitation of minority shareholders by controlling shareholders. This agency problem has been referred to as the 'horizontal agency problem', in contrast to the 'vertical agency problem' between shareholders and managers.⁶³ The horizontal agency problem has been generally considered as more serious in companies with controlling shareholders. The shareholder in *de facto* control of the affairs of the company may extract private benefits of control through various means such as 'tunnelling' at the expense of minority shareholders.⁶⁴

Adherents of agency analysis have generally regarded the Anglo-American outsider-based model as a more effective one than the German-Japanese insider-based model (The main features of these two models will be discussed in Chapter 3). This is because the former provides mechanisms to resolve the vertical agency problem, while attempting to avoid the horizontal problem.⁶⁵ This is despite the fact that the two

⁵⁹ Ibid 313.

⁶⁰ Ibid.

⁶¹ Roberta Romano, 'Corporate Law and Corporate Governance' (1996) 5 *Industrial and Corporate Change* 277, 278; Tomasic, Bottomley and McQueen, above n 55, 57-58.

⁶² G.P. Stapleton, *Institutional Shareholders and Corporate Governance* (Clarendon Press, 1996).

⁶³ Donald Clarke, 'the Ecology of Corporate Governance in China' (GWU Legal Studies Research Paper No. 433; GWU Law School Public Law Research Paper No. 433, 29 August 2008) 4 <<http://ssrn.com/abstract=1245803>>; Mark J. Roe, 'The Institutions of Corporate Governance' (Harvard University, John M. Olin Center for Law, Economics, and Business Discussion Paper No. 488, Aug. 2004) 2-3 <<http://ssrn.com/abstract=612362>>.

⁶⁴ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, 'Corporate Ownership Around the World' 1999 (54) *Journal of Finance* 71; Simon Johnson et al, 'Tunnelling' (2000) 90 *American Economic Review* 22; Alexander Dyck and Luigi Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 *Journal of Finance* 537; Mara Faccio, Larry H.P. Lang and Leslie Young, 'Dividends and Expropriation' (2001) 91 *American Economic Review* 54, 55.

⁶⁵ Alan Dignam and Michael Galanis, *The Globalization of Corporate Governance* (Ashgate, 2009) 46.

models, as proponents of transaction cost economics argue, function according to different principles. While the Anglo-American model has prioritised the agency problem, the German-Japanese insider-based systems tend to focus on the reduction of transaction costs through building long term and stable intra and inter-firm relations.⁶⁶

The enlarged agency problems associated with state ownership of companies have also been well documented in the literature. Certain arguments identify the positive aspects of the state as a dominant shareholder. For example, a 'publicly spirited' bureaucrat may take a more long-term view about the development of enterprises with state investment.⁶⁷ Therefore, it may improve the efficiency of the enterprises by controlling their decision-making. State-owned or controlled enterprises are, however, generally regarded as less efficient than their private sector counterparts in the Anglo-American literature.⁶⁸ This has partly been attributed to the 'complex chain of agents (management, board, ownership entities, ministries, the government)', coupled with the passive and absentee ultimate owners (the whole people).⁶⁹ The incentives for the government to monitor SOEs are seen as 'uncertain', since unlike an individual, the whole people (as the principal) are unable to write an explicit contract with the government (as the agent) to align their interests.⁷⁰ Furthermore, the multiple objectives of the state may allow non-profit maximising considerations to continue to be a factor when company decisions are made.⁷¹

Within the broad agency theory of the firm-based analysis, the law and finance analysis (the 'law matters thesis'), represented by the work of La Porta, Lopez-de-Silanes, Shleifer and Vishny (LLSV), has been highly influential.⁷² While recognising the

⁶⁶ Karl Kestrel, 'American and Japanese Corporate Governance: Convergence to Best Practice?' in Suzanne Berger and Ronald Dore (eds), *National Diversity and Global Capitalism* (Cornell University Press, 1996) 107, 108; Peter Gourevitch, 'Corporate Governance: Global Markets, National Politics' in Miles Kahler and David A. Lake (eds), *Governance in a Global Economy* (Princeton University Press, 2003) 305, 308-9.

⁶⁷ Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52 *Journal of Finance* 737, 767.

⁶⁸ Ibid; Roman Tomasic and Jenny Jian Rong Fu, 'Government-owned Companies and Corporate Governance in Australian and China: Beyond Fragmented Governance' (2006) 3 *Corporate Ownership and Control* 123-4.

⁶⁹ *OECD Guidelines on Corporate Governance of State-owned Enterprises* (2005), Preamble, 10.

⁷⁰ Andrew Yuen and Anming Zhang, 'An Economic Perspective on Recent Corporate Governance Developments in China with Comments on Chapters by Yang, Gu and Wang', in Masao Nakamura (ed), *Changing Corporate Governance Practices in China and Japan: Adaptations of Anglo-American Practices* (Palgrave Macmillan, 2008) 63, 73.

⁷¹ Michael Whincop, *Corporate Governance in Government Corporations* (Aldershot, Ashgate Publishing, 2005) 7-11; Ross Grantham, 'The Governance of Government Owned Corporations' (2005) 23 *Companies and Securities Law Journal* 181, 189-91.

⁷² See, eg, Rafael La Porta et al, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131; Rafael La Porta et al, 'Investor Protection and Corporate Governance' (2000) 58 *Journal of Financial Economics*

agency problem between shareholders and managers, the law matters thesis places the role of law at the centre of solutions to that problem. LLSV assert that legal protection for investors, which includes not only the law and regulations in the books but also the quality of their enforcement, plays a central role in understanding the variation in ownership concentration as an important aspect of corporate governance in different countries.⁷³ Based on this rationale, the authors recommend countries with poor investor protection to move into a more protective regime (namely, the common law system) through legal (which requires the introduction of radical legal changes) or functional convergence (by, for example, liberalisation of domestic capital market).⁷⁴ LLSV's law and finance analysis has not only reinforced the superiority of the Anglo-American outsider-based model in world systems of corporate governance, but also played a pivotal role in driving various law and economic development programs carried out by international financial institutions (for example, the World Bank and the International Monetary Fund) towards developing countries.⁷⁵

Transaction cost economics has been employed in some studies on the governance of SOEs. For example, Keister adopted this approach in her study of 40 largest business groups in China and found a positive correlation between financial performance of group member firms and group formation, intra-group finance and exchange networks.⁷⁶ However, due in part to the popularity of the outsider-based governance model (and the associated agency-based analysis) among Chinese researchers as discussed next, transition costs economics has never become influential in corporate governance studies in China.⁷⁷

Many scholars favouring agency-based analysis have been associated with international economic organisations and financial institutions. Apparently, in prodding China to move towards the outsider-based model, these institutions have incorporated the "good

3; Rafael La Porta et al, 'Law and Finance' (1998) 106 *Journal of political Economy* 1113; La Porta, Lopez-de-Silanes and Shleifer, above n 64.

⁷³ La Porta et al, 'Investor Protection and Corporate Governance', above n 72, 5.

⁷⁴ Ibid 20-23; For the distinction between legal and functional convergence, see John Coffee, 'The future as History: the Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwest University Law Review* 631.

⁷⁵ Curtis Milhaupt and Katherine Pistor, *Law and Capitalism: What Corporate Crisis Reveal about Legal systems and Economic Development around the World* (Chicago University Press, 2008) 20.

⁷⁶ Lisa Keister, *Chinese Business Groups: The Structure and Impact of Interfirm Relations during Economic Development* (Oxford University Press, 2000).

⁷⁷ Jian Chen, *Corporate Governance in China* (RoutledgeCurzon, 2005) 22.

governance" agenda into their organisational agendas.⁷⁸ Various aspects of corporate governance in listed SOEs, such as shareholding structure, board of directors, corporate disclosure and the regulation of capital market, have been analysed, or more specifically, critiqued by researchers from the Organization for Economic Co-operation and Development (OECD),⁷⁹ the World Bank,⁸⁰ the International Institute of Finance (IIF)⁸¹ and international credit rating agencies such as Standard and Poor's.⁸²

Agency-based analysis has also been adopted by many other researchers from Anglo-American countries and Chinese scholars subscribing to the outsider-based model.⁸³ To these researchers, the adoption of this model would be a natural consequence of the advent of market-oriented reforms in China that began in the late 1970s.

For example, focusing on the agency problems associated with the state as a shareholder, many researchers have regarded state retaining the controlling shareholdings in listed companies as a major obstacle for China to achieve international standard of good corporate governance. For these researchers, state involvement in companies seems to lead to various problems, such as the lack of board independence and accountability, poor disclosure and transparency and weak protection for outsider shareholders.⁸⁴ There is also a sizable law and finance analysis, preoccupied with how

⁷⁸ Jude Howell, 'Reflections on the Chinese State' (2006) 37 *Development and Change* 273, 277.

⁷⁹ The OECD has been engaged in a policy dialogue on corporate governance with the Chinese government. For more information on the dialogue see OECD website, <http://www.oecd.org/document/61/0,2340,en_2649_34813_34970813_1_1_1_1,00.html>.

⁸⁰ Stoyan Tenev and Chunlin Zhang with Loup Brefort, *Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets* (The World Bank, 2002); The World Bank, *China's Management of Enterprise Assets: The State as Shareholder* (The World Bank, 1997).

⁸¹ Institute of International Finance, *Task Force Report Corporate Governance in China: An Investor Perspective* (March 2006) <www.iif.com/download.php?id=1mgJLeLUYo=>>.

⁸² Katrina Tai and Calvin R Wong, 'Standard and Poor's 2003 Country Governance Study: Corporate Governance in China' <<http://icf.soine.yale.edu/research/china/newpaper/cn/feature/mainland/corporate>>.

⁸³ See, eg, Jian Chen, above n 77; Donald Clarke, 'Corporate governance in China: an review' (2003) 14 *China Economic Review* 494; Shanghai Stock Exchange, *China Corporate Governance Report 2003: Executive Summary* <edu.sse.com.cn/cs/zhs/xxfw/research/books/books20030601c.pdf>; Qiang Qu, 'Corporate Governance and State-owned Shares' (2003) 14 *Journal of Asian Economies* 771; Xiao Nian Xu and Yan Wang, 'Ownership Structure and Corporate Governance in Chinese Stock Companies' (1999) 10 *China Economic Review* 75; Ma Zhong and Cai Lin, 'The Ownership Structure and Internal Capital Market in Chinese Business Group Affiliation of Listed Corporations' (2004) 17 *Australian Journal of Corporate Law* 33; Jin-qian Qiu, 'Corporate Governance in China: from the Protection of Minority Shareholder Perspective' (2006) 2 *Corporate Governance Law Review* 311; Yingyi Qian, 'Government Control in Corporate Governance as a Transitional Institution: Lessons from China', In Joseph Stiglitz and Shahid Yusuf (eds), *Rethinking the East Asian Miracle* (Oxford University Press, 2001) 295.

⁸⁴ For example, in *China Corporate Governance Report 2003: Executive Summary*, the Shanghai Stock Exchange noted that controllers of Chinese listed companies were 'governed by political incentives and individual utility maximization instead of shareholders' value'. See Shanghai Stock Exchange, *China Corporate Governance Report 2003: Executive Summary*, above n 83; See also Donald Clarke, 'The Independent Director in Chinese Corporate Governance' (2006) 31 *Delaware Journal of Corporate Law* 125, 143; Jian Chen, above n 77, 26, 148; Institute of International Finance, above n 81.

to improve different aspects of the Chinese systems of corporate law and corporate governance, by drawing upon experience of Anglo-American countries, primarily the US.⁸⁵

Not surprisingly, the assessment of corporate governance in China through the lens of agency theory has led to various reform recommendations based on governance mechanisms of the outsider-based model, including withdrawing the influence of the state from companies. For example, in a 2002 assessment of China's progress in corporate governance and enterprise reform, three World Bank economists urged Chinese policy makers to address the agency costs of government ownership through, among other means, separating government control rights from cash flow rights (for example by allowing private, including foreign, institutional investors to manage listed state shares) and reducing state ownership (such as by fostering institutional investment). Consistent with the outsider-based model, other recommendations of the World Bank included establishing credible penalties for failure through strengthening the enterprise bankruptcy system, delisting and hostile takeover laws, promoting board independence, professionalising corporate directors, empowering shareholders (including institutional shareholders) and developing capital markets that reward good corporate governance.⁸⁶ The IIF has also recommended withdrawal of the state from companies. For example, the IIF stated in its 2006 evaluation of Chinese corporate governance:

The government's recent steps to improve corporate governance, important as they are, do not provide a long term solution for the major corporate governance problems in China. To bring about real effective change, it is necessary that the government reduce its role and influence in Chinese companies.⁸⁷

Some agency theorists do recognise a continued role for the state in Chinese corporate governance. In doing so, they stress that the legal and market institutions are underdeveloped in China, which may undermine the effective functioning of Anglo-American market-based mechanisms of corporate governance. These deficiencies

⁸⁵ See, eg, Jian Chen, above n 77; Hui Huang, 'the Statutory Derivative Action in China: Critical Analysis and Recommendations for Reform' (2007) 4 *Berkeley Business Law Journal* 227; S. H. Goo and Anne Carver, 'Low Structure, High Ambiguity: Selective Adaptation of International Norms of Corporate Governance Mechanisms in China', in Masao Nakamura (ed), *Changing Corporate Governance Practices in China and Japan* (Palgrave Macmillan, 2008) 206.

⁸⁶ Tenev and Zhang with Brefort, above n 80, 127-60.

⁸⁷ Institute of International Finance, above n 81, 3-4.

therefore require state involvement as a 'second-best response'.⁸⁸ For example, rejecting a wholesale transplantation of the outsider-based model of corporate governance into China, Tam proposed a 'self-enforcing model' that seeks to empower various corporate organs and actors, including the state, in the governance of listed SOEs.⁸⁹

However, these researchers generally consider that state involvement in companies should be confined to a shareholder role, thereby supporting the 'withdrawal of the state' view.⁹⁰ This view is also reflected in the *OECD Guidelines on the Corporate Governance of State-owned Enterprises*.⁹¹ The *Guidelines*, while encouraging the state to act as 'an informed and active owner',⁹² call for 'a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly market regulation.'⁹³

2.3.2 Path dependence analysis

Given the distinctiveness of China's historical and institutional background, path dependence analysis has also been a popular approach to the study of various aspects of Chinese corporate governance, ranging from corporate disclosure,⁹⁴ board governance,⁹⁵ corporate and stock market regulation,⁹⁶ to the impact of overseas listing on the governance practices in Chinese SOEs.⁹⁷

Path dependence analysis has been associated with a longstanding debate over the convergence or divergence of national systems of corporate governance. The rise to prominence of the Anglo-American outsider-based model in the 1990s generated a widespread prediction that national systems of corporate governance would converge into one single most efficient model, namely, the outsider-based model as the 'standard

⁸⁸ See, eg, Qian, above n 83, 299. Cindy A. Schipani and Junhai Liu, 'Corporate Governance in China, then and now' (2002) *Columbia Business Law Review* 1, 28-32; Katharina Pistor and Chenggang Xu, 'Governing Emerging Stock Markets: Legal vs Administrative Governance' (2005) 13 *Corporate Governance: An International Review* 5,6; On kit Tam, *The Development of Corporate Governance in China* (Edward Elgar Publishing, 1999) 97.

⁸⁹ Tam, above n 88.

⁹⁰ Ibid 104; Schipani and Liu, above n 88.

⁹¹ *OECD Guidelines on the Corporate Governance of State-owned Enterprises* (2005).

⁹² Ibid 5.

⁹³ Ibid 4.

⁹⁴ Jane Fu, *Corporate Disclosure and Corporate Governance in China* (Wolters Kluwer, 2010).

⁹⁵ Angus Young, Grace Li, and Alex Lau, 'Corporate Governance in China: The Role of the State and Ideology in Shaping Reforms' (2007) 28 *The Company Lawyer* 204.

⁹⁶ Chenxia Shi, *Political Determinants of Corporate Governance in China* (Routledge, 2012).

⁹⁷ Alice De Jonge, *Corporate Governance and China's H-Share Market* (Edward Elgar, 2008).

model'.⁹⁸ The convergence theory is, however, in doubt, after the high profile corporate collapses and scandals (for example, Enron and WorldCom) in the US during the early 2000s,⁹⁹ and the more recent Global Financial Crisis (GFC) which exposed many failures of outsider-based systems.¹⁰⁰

Nevertheless, the convergence theory has been significantly enriched by a debate about the analytical approaches to comparative corporate governance studies. Chief among these is path dependence analysis that has served as the dominant theoretical foundation for the divergence thesis. The notion of path dependence¹⁰¹ was first introduced into comparative corporate law research by Roe, who argued that, instead of simply being determined by market forces, a country's system of corporate governance is shaped by the system it had in place at earlier times.¹⁰² In other words, history matters.¹⁰³ In his later work with Bebchuk, the two authors focused on the self-reinforcing effects of two main factors for path dependence, namely, corporate ownership structures and corporate rules of a given country.¹⁰⁴ These authors, however, did acknowledge some other elements for path dependence, such as differences in economic and market conditions, culture and political ideology. These factors were not considered to be 'rooted in path dependence,' but they could 'set up the initial conditions' for path dependence.¹⁰⁵

Following Bebchuk and Roe, other factors that may engender path dependence in corporate governance have also been identified. These have included politics,¹⁰⁶

⁹⁸ Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 443; Brian Cheffins, 'Corporate Governance: Lessons from Australia' (2002) 16 *The Transnational Lawyer* 13, 16; Thomas Clarke, 'Introduction: Theories of Governance-Reconceptualising Corporate Governance Theory after the Enron Experience', above n 54, 11; Dignam and Galanis, above n 65, 45-47.

⁹⁹ Thomas Clarke, 'Introduction', above n 54, 14.

¹⁰⁰ Roman Tomasic and Folarin Akinbami 'Towards a New Corporate Governance after the Global Financial Crisis' 2011 (22) *International Company and Commercial Law Review* 237; Roman Tomasic, 'Looking at Corporate Governance in China's Large Companies: Is the Glass Half Full or Half Empty?' in Guanghua Yu (ed), *The Development of the Chinese Legal System Change and Challenges* (Routledge, 2010) 182, 192.

¹⁰¹ The notion of path dependence was seen by Farrar as 'to some extent an application to law and economic phenomena of a metaphor taken from mathematics, physics and biological science'. John Farrar, *Corporate Governance: Theories, Principles and Practice* (Oxford University Press, 2nd ed, 2004) 462.

¹⁰² Mark J. Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press, 1996) 275-81.

¹⁰³ Reinhard Schmidt and Gerald Spindler, 'Path Dependence and Complementarity in Corporate Governance', in Jeffrey Gordon and Mark J. Roe (eds), *Convergence and Persistence in Corporate Governance* (Cambridge University Press, 2004) 114, 114.

¹⁰⁴ Lucian Arye Bebchuk and Mark J. Roe, 'A theory of path dependence in Corporate ownership and governance' in Jeffrey N. Gordon and Mark J. Roe (eds), *Convergence and Persistence in Corporate Governance* (Cambridge University Press, 2004) 69.

¹⁰⁵ *Ibid* 109.

¹⁰⁶ Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press, 2003).

culture,¹⁰⁷ legal systems,¹⁰⁸ and industrial organisation.¹⁰⁹ The categories do not seem to be closed. Perhaps for that reason, studies focusing on the influence of wider social, political and cultural institutions on corporate governance, including the interest groups politics approach to be discussed later, have often been treated as path dependence analysis.¹¹⁰

Researchers that apply path dependence analysis to the study of Chinese corporate governance, while often conscious of the various advantages of the outsider-based model, tend to focus on elements in the Chinese indigenous conditions that prevent the country from fully embracing that model.¹¹¹ According to various authors, these obstacles include China's socialist ideology,¹¹² the legacy of its former Soviet-style planned economy,¹¹³ inadequate institutions involved in the enforcement of corporate governance rules¹¹⁴ and the Chinese collectivist cultural traditions including the 'traditional Chinese view of the corporation as a kinship group'.¹¹⁵

Politics, particularly the Chinese Party-state's reluctance to relinquish its power over large companies, has featured strongly in this analysis.¹¹⁶ For example, linking the Chinese institutional capacity to the common complaints about the lack of enforcement of corporate governance rules in China, Clarke examined the roles played by various state-based and non-stated-based institutions such as the China Securities Regulatory Commission (CSRC), the stock exchanges, the accounting and legal professions and the financial media. The examination led him to conclude that 'the state for political

¹⁰⁷ Amir N. Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 *Delaware Journal of Corporate Law* 147, 147.

¹⁰⁸ Bernard S. Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' 2001 (48) *UCLA Law Review* 781.

¹⁰⁹ Ronald Gilson, 'Corporate Governance and Economic Efficiency: When Do Institutions Matter?' 1996 (74) *Washington University Law Quarterly* 327, 334-5.

¹¹⁰ Licht, above n 107, 162-3

¹¹¹ See, eg, Jane Fu, above n 94, 305-9.

¹¹² Chao Xi, *Corporate Governance and Legal Reform in China* (Wildy, Simmonds & Hill Publishing, 2009) 14-15, 34.

¹¹³ Aron Viner, 'Corporate Governance in China', in Joseph C F Lufkin (ed), *International Corporate Governance: Strategic Action Plans for Management and Investors* (Euromoney Books, 2003) 137, 153-4.

¹¹⁴ For a discussion of these institutions, see Donald Clarke, 'The Ecology of Corporate Governance in China,' above n 63, 15-55.

¹¹⁵ Ruskola Teemu, 'Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective' in (2000) 52 *Stanford Law Review* 1599, 1599.

¹¹⁶ Peter A Gourevitch and James Shinn, *Political Power and Corporate Control* (Princeton University Press, 2007) 192-9; De Jonge, above n 97, 12-13; Viner described Chinese corporate governance as 'birdcage corporate governance', referring to the state's continuing control of the development of the financial markets and market economy in China. See Viner, above n 113.

reasons prefers to leave enforcement to state regulatory bodies'.¹¹⁷ Unfortunately, the enforcement by these state regulatory bodies has not been strong. This is, in part, due to various limitations suffered by these bodies such as the dual role of the CSRC as a regulator and market promoter, and the lack of independence of the courts from local governments. On the other hand, according to Clarke, China's 'repression of civil society institutions is so severe that even a modest relaxation could have substantial benefits'.¹¹⁸ Furthermore, the adoption of path dependence analysis has led Shi to observe little change to the pervasive role played by the state in the development of corporate legislation and regulation of the stock market. As Shi stated, 'the social, economic and, particularly, political conditions under which Chinese corporate governance evolves offer little support for the prospect of full convergence within international models and practices'.¹¹⁹

2.3.3 The interest group politics approach

With China's rapid economic development and the pluralisation of interests both within and outside the state bureaucracies, a third approach, namely, the political, or interest group politics approach, has been adopted by commentators such as Xi.¹²⁰ Political analysis of corporate governance began with William Cary¹²¹ and was developed by Romano,¹²² Roe¹²³ and Gourevitch and Shinn.¹²⁴ Often treated as a subset of path dependence analysis, the political approach has, nevertheless, provided some distinct analytical frames of its own.

Researchers in the politics school have generally adopted an interest groups politics approach in their analysis of the attributes of politics and how it works to shape share ownership structure, as a central component of corporate governance. For example, Roe focused on class conflict between capital and labour (i.e. shareholders and employees) and the role of 'social democracy', meaning 'employee pressures', in the settlement of

¹¹⁷ Donald Clarke, 'The Ecology of Corporate Governance in China,' above n 63, Abstract.

¹¹⁸ Ibid.

¹¹⁹ Shi, above n 96, 19. The tension between central and local governments' powers over businesses formed part of Alice De Jonge's analysis of corporate governance of the first nine mainland companies listed in Hong Kong. See De Jonge, above n 97.

¹²⁰ Chao Xi, above n 112, 187-9.

¹²¹ William L. Cary, 'Federalism and Corporate Law: Reflections upon Delaware' 1974 (83) *Yale Law Journal* 663; Licht, above n 107, 161.

¹²² Roberta Romano, 'The Political Economy of Takeover Statutes' 1987 (73) *Virginia Law Review* 111.

¹²³ Roe, *Political Determinants of Corporate Governance*, above n 106.

¹²⁴ Peter A Gourevitch and James Shinn, *Political Power and Corporate Control* (Princeton University Press, 2007).

that conflict.¹²⁵ He found that countries with strong democracy tend to be associated with concentrated share ownership or the *vice versa*, diffused ownership.¹²⁶ Roe's political analysis has been taken on by Gourevitch and Shinn whose conceptualisation of interest group politics is far more complex and dynamic.¹²⁷ While Roe focused his political explanation on the share ownership structure in major industrialised countries, Gourevitch and Shinn sought to test their model against corporate governance in a larger number of countries including developing countries such as China.

Focusing on the legal reform of board governance in Chinese listed companies, Xi argues that the formulation of the relevant provisions in the 2005 *Company Law* has been shaped by the interplay between socialist ideology and dynamics of interest group politics. The latter involve parties such as the controlling shareholders, senior managers, independent directors, members of the supervisory board and the workers' union. Taking the system of independent directors as an example, the initial version of the draft rules, mirroring relevant CSRC guidelines, was far more detailed and rigorous.¹²⁸ These draft provisions were, however, removed and replaced by a broadly worded article in the new *Company Law* that defers the power of the legislature to formulate more detailed rules in the area to the central government.¹²⁹ This was attributed by Xi to the battle of interest group interests, particularly strong opposition from powerful actors such as SASAC, and leaders of large SOEs.¹³⁰ The interest group politics approach has also been employed by Xi in his analysis of the transplantation of the Anglo-American doctrine of 'piercing the corporate veil' into the 2005 *Company Law*.¹³¹

¹²⁵ Roe, above n106, 24.

¹²⁶ This is because in strong social democracies, managers are pressed to unite with employees instead of shareholders. Shareholders have to seek other means to control managers, resulting in concentrated share ownership. See Roe, above n 106, 8.

¹²⁷ Unlike Roe who focused on only one viable, namely, labour power, and two players, owners and managers, Gourevitch and Shinn saw politics as entailing both political institutions and interest groups including owners, labours, as well as managers as a group in its own right. Interest groups advocate policies that promote their interests. In doing so, they may form different coalitional lineups along different cleavages such as class conflict and sectoral models. Political institutions then aggregate preferences or interests of the winning coalitions into policy outcomes, which in turn shape incentives leading to the ultimate structure in corporate governance system. See Gourevitch and Shinn, above n 124, 15-16.

¹²⁸ 《关于在上市公司建立独立董事制度的指导意见》 [Guidelines for the Introduction of Independent Directors into Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 16 August 2001.

¹²⁹ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005, art 123.

¹³⁰ Xi, above n 112, 204-7.

¹³¹ Chao Xi, 'Piercing the Corporate Veil in China: How did We get There?' (2011) 5 *Journal of Business Law* 413

The three approaches to the analysis of Chinese corporate governance discussed above have offered many valid and useful interpretations of the role of the state in corporate governance in China. Agency analysis highlights the fact that the very notion of corporate governance was borrowed from the Western advanced market economies, especially the US and the UK. The path dependence and the interest group politics approaches illuminate the multiple indigenous factors that shape the evolution of Chinese corporate governance, as the country shifted from a former Soviet-style command system towards a more market-oriented one.

However, these three approaches have one significant limitation. An important determinant of corporate governance, namely, the Chinese form of state-led economic development, appears to be missing in all three approaches. By presupposing shareholder-oriented benefits as the sole objective of corporate governance, agency analysis overlooks the diverse functions served by corporate governance in different economic models.¹³² As illustrated in Chapter 3, national systems of corporate governance cannot be separated from their economic systems. The post-war French and Japanese corporatist systems during the 1950s to the 1980s have demonstrated that large businesses may be vital tools of the state for economic development. Indeed, agency analysis has already encountered difficulty in interpreting corporate governance in China. As the review of the literature on the Chinese form of state capitalism in section 2.2 suggested, the 'withdrawal of the state from enterprises' type of advice, offered by many Anglo-American researchers, seems to be at odds with the increased rather than loosened state-business ties in China over the past few years.

On the other hand, while path dependence analysis helps explain the persistence of state control of large companies, this historical and political ideological-oriented approach appears to have downplayed a rather proactive and innovative aspect of the role played by the state in Chinese economic and enterprise reforms. As also discussed in Chapter 2.2, this aspect is an important feature of the Chinese form of state capitalism. Similarly, this aspect of the role of the state has also been buried in Xi's interest group politics approach to the Chinese corporate governance. In his analysis, the various actors in Chinese corporate governance are autonomous and discrete elements which interact with each other in the policy making process on the basis of self-interest.

¹³² Gordon Redding, 'The Conditional Relevance of Corporate Governance Advice in the Context of Asian Business Systems' in Thomas Clarke and Marie Dela Rama (eds), *Corporate Governance and Globalisation* (Sage Publications, 2006) Vol 2, 98, 102.

2.3.4 State capitalism and institutional change as an alternative approach

Outside these three main approaches to the Chinese corporate governance, an emerging body of studies has, either implied or explicitly, linked aspects of corporate governance in listed SOEs with the Chinese state-led economic development. As discussed below, while these studies have provided some inspirations, or lent support, to the analytical approach employed in this thesis, they are not without limitations, due in part to their piecemeal nature.

Within this small body of literature, Milhaupt and Pistor's characterisation of the Chinese corporate governance has provided some insights for this research. In their 2008 book *Law and Capitalism*,¹³³ Milhaupt and Pistor used the Chinese government and the parent company's involvement in the collapse of China Aviation Oil (CAO, a Hong Kong-listed company) as one of their country case studies to illustrate a larger theme. As will be discussed in Chapter 3, this is the role of the state in the interaction between changes in law, as a particular type of institution, and economic changes. In doing so, the authors argued that Chinese corporate governance 'can be best described as an administrative model'.¹³⁴ Hence, consistent with the role of law in China as an instrument of state control and coordination of the economy and society,¹³⁵ corporate governance 'perform[s] mainly coordinating functions'.¹³⁶ In other words, unlike the investor protection function served by corporate governance in Anglo-American jurisdictions, this model is primarily a tool of the state (and state holding companies) for coordination of interests among favoured groups (such as state bureaucracies, enterprises, and foreign institutional investors) while holding the rights of outsider shareholders in check.¹³⁷ According to Milhaupt and Pistor, this model resembles corporate governance in some East Asian former state-led economies, such as South Korea.¹³⁸ The need to attract foreign investors and to improve the governance in Chinese companies has prompted the government to adopt more shareholder protection-oriented rules. This, however, did not alter the primary function served by corporate

¹³³ Milhaupt and Pistor, above n 75. As will be explained in Chapter 3, the term 'state capitalism' is not used by the authors but can be implied.

¹³⁴ Ibid 139.

¹³⁵ Ibid 144.

¹³⁶ Ibid 139.

¹³⁷ Ibid 139, 147.

¹³⁸ Ibid 147.

governance.¹³⁹ As the authors concluded, '[p]lainly, the protective function of law is still a work in progress in China'.¹⁴⁰

Milhaupt and Pistor's characterisation of Chinese corporate governance as 'the administrative model', as well as their interpretation of the role of the state in the interaction between legal and economic changes in state-led systems, was instrumental to the formulation of the analytical framework for this research. Nevertheless, their study has some limitations. The limitations of their analysis of the role of the state in legal changes will be discussed in Chapter 3. In relation to corporate governance, their study of the CAO's case has not provided a full account of the evolution of China's state-led corporate governance with socioeconomic changes over the past few years. Firstly, with a strong emphasis on the impact of the interaction between state power and economic changes on the development of the law and practice concerning state (controlling shareholder)-manager relations and investor protection in listed SOEs, the authors have overlooked non-shareholder stakeholder protection, as a third set of company relations central to the former state-led model of corporate governance. This limitation may have been contributed by the methodology adopted by the authors. A single case study on Chinese corporate governance obviously limits the range of issues that could be dealt with. Secondly, the 'administrative model' was posited by Milhaupt and Pistor based on Chinese corporate governance law and practice up until 2006. As Chapters 6 to 8 will illustrate, significant changes in international and domestic environments have since taken place, and led to further reforms of corporate governance in China.

Some other more recent studies have also lent support to a state capitalism perspective to the governance of Chinese listed SOEs. First, in a working paper entitled '*We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*', Lin and Milhaupt sought to unpack the 'institutional ecology' of central SOEs, seen by the authors as the 'full expression of state capitalism in China'.¹⁴¹ In doing so, Lin and Milhaupt provided a detailed account of the intra-group structures of central SOEs and the various mechanisms that tie these large groups to SASAC as their ultimate controller.

¹³⁹ Ibid 144, 187-8.

¹⁴⁰ Ibid 144.

¹⁴¹ Li-Wen Lin and Curtis J. Milhaupt, 'We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China' (Columbia Law school Working Paper No.409, 1 November 2011) 5 <<http://ssrn.com/abstract=1952623>>.

Also, the links between China's state-led economic development and Chinese central and local governments' recent efforts on promoting corporate social responsibility have been considered by Ho and Lin.¹⁴² In an article published by Ho in 2013, she distinguished between the state-centric model of corporate social responsibility in China from a market-driven (which prevails in the US), and a relational approach (represented by Germany and other Western European countries) in Western economies. In the market-driven model, companies' impetus for advancing corporate social responsibility is mainly derived from market forces, civil society and business self-regulation. Therefore, beyond traditional regulatory spheres, the governments, at both national and local levels, tend to play an indirect role through leading by example and adopting collaborative programs that encourage corporate commitment to social responsibility.¹⁴³ Compared to the market-driven model, the relational model attaches more importance to state partnership with businesses and non-government organisations in formulating and implementing shared policy agendas.¹⁴⁴ Yet, a similarity shared by the two models is a strong direct role played by market forces, civil society and business self-regulation in promoting corporate social responsibility.¹⁴⁵ This feature, according to Ho, stands as a sharp contrast to the Chinese state-centric model in which the state plays a dominant role in the formulation and implementation of relevant policy, rules and guidelines.¹⁴⁶

By highlighting the relationship between the Chinese form of state-led economic development and state-led corporate governance, these more recent studies shed further light on a state capitalism approach to Chinese corporate governance. However, these studies have their own limitations. While the analysis of this theoretical foundation is quite thin (With respect to Lin and Milhaupt's and Ho's studies, there is no more than a reference to state capitalism), each of these three studies has focused on particular aspect of corporate governance in listed SOEs in China. While Lin and Milhaupt's work focused on state-manager relations in central SOEs, Ho's and Lin's articles solely concern corporate social responsibility. Therefore, none of these studies has offered a full account of the law and practice concerning all three sets of relations (state-manager

¹⁴² Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375; Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 *Berkeley Journal of International Law* 64.

¹⁴³ Ho, above n 142, 388-91.

¹⁴⁴ Ibid 391-5.

¹⁴⁵ Ibid 425-6.

¹⁴⁶ Ibid 424-5.

relations, investor protection and non-shareholder stakeholder protection) in Chinese listed SOEs, let alone the impact of the interaction between state power and growing international and domestic pressures for change on the evolution of those relations. Indeed, as Chapter 8 will illustrate, these forces had become particularly pressing in the lead up to the 2005 corporate law reforms.

2.4 Conclusion

This chapter has illustrated the need for a state capitalism and institutional approach to the governance of Chinese listed SOEs by identifying the gap between two important strands of literature on China, namely, the Chinese form of economic development, and Chinese corporate governance. Despite China being increasingly labelled as state capitalism, this trend in political economic literature has been significantly under-represented in studies on Chinese corporate governance. None of the main analytical approaches adopted in the literature has contextualised the governance of listed SOEs within the Chinese state-led economic development model.

This chapter has also shown that a linkage between these two spheres has been reflected in a small number of studies on Chinese corporate governance. These few studies, however, suffer from a number of limitations due to their piecemeal nature. In addition to insufficient analysis of the theoretical foundation, they have focused on particular aspects of corporate governance in Chinese listed SOEs, mainly the extent of state control over corporate managers and investor protection. These studies have therefore failed to provide a broader analysis of the impact of the Chinese form of state capitalism on all three sets of relations central to state-led corporate governance. A third limitation is that most of these studies have not paid sufficient attention to the rapid changes in international and domestic environments faced by Chinese policy makers in maintaining its state-led economic development, and the impact of those changes on more recent corporate governance reforms in China. These deficiencies, as this chapter has argued, call for a detailed and comprehensive study of corporate governance in Chinese listed SOEs through the perspective of state capitalism and institutional change, by taking into account the interaction between the role of the state and international and domestic forces for change. Chapter 3 begins this analysis by setting out the theoretical framework for this study.

CHAPTER 3 THEORETICAL FRAMEWORK

3.1 Introduction

A state capitalism and institutional change approach to the governance of listed state-owned enterprises (SOEs) in China requires the consideration of three theoretical issues. First, is there a linkage between national systems of corporate governance and national economic development models? If that question can be answered in the affirmative, second, in what ways does state capitalism, as a particular economic development model, shape the system of corporate governance in a given country? And finally, how may the role of the state shape changes in corporate governance in state-led economies as international and domestic conditions evolve?

This chapter addresses these three questions by drawing upon three interrelated strands of literature. These are comparative capitalism, comparative corporate governance, particularly governance of large companies in post-World War II East Asian state-led economies, and law and capitalism, particularly Milhaupt and Pistor's postulation of the role of the state in the interaction between legal and economic changes within state-led economies.¹

This chapter is divided into six sections. Section 3.2 provides a brief overview of comparative capitalism and the analytical approaches utilised in this field. The section then demonstrates the interrelationship between models of capitalist economic development and corporate governance by drawing upon Hall and Soskice,² whose varieties of capitalism (VoC) approach has served as the dominant analytical framework in comparative capitalism. As Section 3.2 will illustrate, Hall and Soskice classify capitalist systems into the Liberal Market Economies (LMEs) and Coordinated Market Economies (CMEs) according to their firm-centred institutional arrangements, which shows the correlation between national economic and corporate governance models.³

Section 3.3 illustrates the interrelationship between state capitalism and state-led corporate governance. While Hall and Soskice's analysis helps to establish the linkage

¹ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008).

² Peter Hall and David Soskice, 'An Introduction to Varieties of Capitalism' in Peter Hall and David Soskice (eds), *Varieties of Capitalism: the Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001) 1.

³ Ibid.

between models of capitalism and corporate governance, their firm-centred framework largely ignored the role of the state in capitalist economic development. This section will show that by bringing the state back into the institutional analysis, several more recent studies have not only articulated state capitalism as a distinctive capitalist prototype, but also established the necessary linkage between state capitalism and the state-led model of corporate governance. Together with a sizable literature on corporate governance in the post-war East Asian developmental states, this group of studies has further highlighted the main features of the state-led model centred on three sets of relations, namely, state-manager relations, investor protection and other stakeholder including employee protection.

Section 3.4 considers the role of the state in shaping the interaction between corporate governance and socioeconomic changes in state-led economies. Two prevailing socioeconomic forces pertinent to the recent development of corporate governance in China will be considered. These are economic globalisation and the pluralisation of interests within domestic society. In this respect, the VoC studies, represented by Hall and Soskice, have been widely criticised for failing to provide a satisfactory account for change. As section 3.4 will demonstrate, a much more dynamic view has, nevertheless, been put forward by Milhaupt and Pistor through their exposition of the role of the state in the interaction between legal and economic changes within state-led economies.⁴

Section 3.5 considers the advantages and limitations of the three-component framework proposed in this chapter for the research. As the section will suggest, state capitalism and institutional change provides a conceptual basis for the understanding of the major changes and continuities in the regulation of corporate governance in China. Despite its various limitations, this framework is able to capture the dominant form of capitalism in China, without ignoring the complex international and domestic dynamics being faced by Chinese policy makers.

3.2 Comparative capitalism and corporate governance

Comparative capitalism, or comparative studies of capitalist diversity, are a vast and 'eclectic field'⁵ that draws upon political science and sociology in the study of

⁴ Milhaupt and Pistor, above n 1.

⁵ Terrence Casey, 'Mapping Stability and Change in Advanced Capitalisms' (2009) 7 *Comparative European Politics* 255, 257.

economic phenomenon.⁶ These studies can be traced back to the 1960s, when Shonfield provided a detailed account of the French post-war system of long-term national planning (indicative planning) and recommended its adoption in Britain.⁷ Later in the 1980s, the strong economic performance of Germany and Japan led to further characterisation of distinct forms of capitalism outside the US and the UK.⁸ Studies in this field have, however, been synthesised only recently with the publication of Hall and Soskice's edited book *'Varieties of Capitalism'*.⁹ As Hall and Soskice's analysis quickly became the dominant analytical framework,¹⁰ the two terms, 'comparative capitalism' and 'varieties of capitalism', have been used interchangeably by scholars in the field.¹¹

Starting from Hall and Soskice, an important strand of the varieties of capitalism (VoC) literature has been concerned with the classification of national models of capitalism according to their institutional arrangements.¹² As institutionalists, the VoC scholars share the new institutionalists' basic assertion about the importance of institutions in shaping behaviour of firms and other economic actors (such as employees and the government). However, instead of prioritising one single set of institutions, such as the Anglo-American institutions, for economic growth, these scholars see the distinctive institutional configuration in a given economy as generating 'a particular systemic logic of economic action'.¹³ Following that rationale, different VoC scholars attempt to

⁶ Gregory Jackson and Richard Deeg, 'How Many Varieties of Capitalism? Comparing the Comparative Institutional Analyses of Capitalist Diversity' (MPIFG Discussion Paper No. 06/2, 11 April 2006) 5 <<http://ssrn.com/abstract=896384>>.

⁷ Andrew Shonfield, 'Modern Capitalism' in David Reisman (ed), *Theories of the Mixed Economy* (William Pickering, 1994); Vivien Schmidt, 'Putting the Political Back into Political Economy by Bring the State Back in Yet Again' (2009) 61 *World Politics* 516, 518.

⁸ These include Michel Albert's distinction between a 'Rhine model' (represented by Germany) and the 'Neo-American Capitalism', Ronald Dore's Stock Market Capitalism (typified by the US) versus Welfare Capitalism (represented by Germany and Japan). Furthermore, incorporating the 'developmental state' thesis, David Coates observed that by the end of 1990s, at least three capitalist models can be discerned based on the interrelations between labour, capital and the role of the state. These are market-led (represented by US), negotiated (represented by Germany and the Scandinavian economies) and state-led (typified by Japan and South Korea). See Michel Albert, *Capitalism against Capitalism* (Whurr, 1993); Ronald Dore, *Stock Market Capitalism: Welfare Capitalism* (Oxford University Press, 2000); David Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (Polity Press, 2000) 9-10.

⁹ Hall and Soskice, above n 2.

¹⁰ Chris Howell, 'Varieties of Capitalism: And Then There was One?' (2003) 36 *Comparative Politics* 103, 103; Nahee Kang, 'Globalisation and Institutional Change in the State-led Model: The Case of Corporate Governance in South Korea' (2010) 15 *New Political Economy* 519, 522.

¹¹ For example, while the term 'comparative capitalism' is used by Gregory Jackson and Richard Deeg, the term 'variety of capitalism' is used by Wolfgang Streeck in his review of a similar set of literature. See Jackson and Deeg, above n 6; Wolfgang Streeck, 'E Pluribus Unum? Varieties and Commonalities of Capitalism (MPIFG Discussion Paper 10/12, October 2010) <www.mpifg.de/pu/mpifg_dp/dp10-12.pdf>.

¹² Nick Wailes, Jim Kitay and Russell D. Lansbury, 'Varieties of Capitalism, Corporate Governance and Employment Relations Under Globalisation' in Shelley Marshall, Richard Mitchell and Ian Ramsay (eds) *Varieties of Capitalism, Corporate Governance and Employees* (Melbourne University Press, 2008) 19, 19-20.

¹³ Jackson and Deeg, above n 6, 6; Wailes, Kitay and Lansbury, above n 12, 20-21.

differentiate national models of capitalism according to their institutional configurations and the interrelationship between the subsystems of those configurations (also called the 'institutional domains' or 'domains of economic activity' which can be subdivided into institutions).¹⁴

These attempts have led to the development of a number of analytical frameworks to allow for international comparison of capitalist variety on a much broader scope.¹⁵ Despite different understandings about the composition of the institutional domains and the interrelationship between them, corporate governance has been treated as an essential component in most of these frameworks, in addition to financial systems, labour relations, the role of the state, inter-firm relations and innovation systems.¹⁶ As Marshall *et al* stated:

While the VoC debate generally ranges across a broad spectrum of different questions and topics, the issues of corporate governance and labour management, and the relationship between them, appear crucial, if not decisive, in how different systems are characterised and typified.¹⁷

Under the broad definition of corporate governance adopted in this research, labour management can be seen as part of corporate governance.

Further, while the nexus between national models of capitalism and corporate governance has been identified by most VoC scholars, Hall and Soskice's framework has been widely commended as having 'achieved a level of theoretical sophistication, explanatory scope and predictive ambition that has rapidly made it close to hegemonic in the field'.¹⁸ As discussed below, the limitations of Hall and Soskice's framework, particularly the apolitical approach it adopts, have inspired the formulation of other alternative frameworks, which led to the articulation of state capitalism as a distinct capitalist prototype.

¹⁴ Jackson and Deeg, above n 6, 12.

¹⁵ Ibid 21-28.

¹⁶ Ibid 12-13; Shelley Marshall, Richard Mitchell and Ian Ramsay, 'Varieties of Capitalism, Corporate Governance and Employment Systems in Australia' in Shelley Marshall, Richard Mitchell and Ian Ramsay (eds), *Varieties of Capitalism, Corporate Governance and Employees* (Melbourne University Press, 2008) 1, 4.

¹⁷ Marshall, Mitchell and Ramsay, above n 16.

¹⁸ Howell, above n 10, 103.

In devising their framework for the analysis of capitalist diversity, Hall and Soskice see national economic systems as production regimes,¹⁹ and focus on how cross-country differences are reflected in micro-behaviour at the firm level.²⁰ In doing so, the authors place the firm at the centre of their analysis,²¹ since they concede firms as not only 'the crucial actors in a capitalist economy,' but also key agents of economic adjustments.²²

Adopting a relational view of the firm,²³ and a 'rational actor' intuitionist perspective,²⁴ Hall and Soskice argue that companies in all market economies are faced with coordination problems in four interrelated spheres (institutional domains) that shape their incentives and constraints: financial systems and corporate governance, industrial relations, inter-company relations, vocational training and education systems.²⁵

Based on their observation of how the coordination problems in those four spheres were solved in advanced OECD countries during the mid-1980s to the mid-1990s, Hall and Soskice allocate the countries on a spectrum with the opposite ends of Liberal Market Economies (LME) and Coordinated Market Economies (CME).²⁶ In the LME systems, including countries such as the US, Britain and Australia,²⁷ companies coordinate their activities among firms, and with other economic actors, primarily through corporate hierarchies and competitive market arrangements.²⁸ By contrast, in the CME systems, such as Germany and Japan,²⁹ companies rely more on cooperation through non-market institutions such as business networks to interact with other economic actors within and outside the firm.³⁰

¹⁹ In doing so, Hall and Soskice drew upon Hollingsworth and Boyer's notion of 'social systems of production'. See Rogers Hollingsworth and Robert Boyer, 'Coordination of Economic Actors and Social Systems of Production' in Robert Hollingsworth and Robert Boyer (eds), *Contemporary Capitalism: The Embeddedness of Institutions* (Cambridge University Press, 1999)1, 2.

²⁰ Jackson and Deeg, above n 6, 21.

²¹ Hall and Soskice, above n 2, 5.

²² Ibid, 6.

²³ Ibid.

²⁴ Ibid.

²⁵ Ibid 6-7.

²⁶ Ibid 8.

²⁷ Ibid 19.

²⁸ Ibid 8, 19.

²⁹ Ibid 19.

³⁰ Ibid 8, 19.

Thus, the LME systems are typically characterised by market-based equity financing and the outsider-based/shareholder-oriented model of corporate governance that is attractive to dispersed investors. These features are further associated with market-based arrangements in other spheres of company relations. These include highly fluid labour markets (which do not seek to maintain long-term employee commitments), general education and training and strong inter-firm competition.³¹ By contrast, the CME systems are characterised by long term-oriented bank-based corporate financing and an insider-based model of corporate governance that prioritises network monitoring and exchange of information among business networks. Congruent with these features, the CME systems are also associated with close inter-firm collaboration, cooperative industrial relations and high-levels of vocational training that cultivates firm-specific skills and promotes long term employee commitments.³²

By illuminating different types of institutions at work in shaping company interaction with its insider and outsider stakeholders, Hall and Soskice establish that the corporate governance system of a given economy is not separated from its broader socioeconomic setting. In doing so, they also provide a strong counter thesis for the primacy of the Anglo-American outsider-based corporate governance view. This later view has tended to see the importance of only one set of institutions, namely the market-based institutions. Indeed, by employing the notions of 'institutional complementarities' and 'comparative institutional advantage' (as will be discussed in section 3.4), Hall and Soskice demonstrate that neither the LME nor the CME systems are inherently superior to the other. Both models are capable of sustaining outstanding economic performance.³³

Indeed, through linking corporate governance with national economic institutional arrangements, comparative capitalism, including Hall and Soskice's framework, has laid the theoretical foundation for a popular comparative capitalism approach to comparative corporate governance studies. As Kang and Moon observed, 'the VoC

³¹ Ibid 27-33.

³² Ibid 21-27.

³³ Ibid 21.

approach provides a way of understanding the firm in a structural and institutionalist manner, i.e., giving micro-foundations to macro-societal phenomenon'.³⁴

On the other hand, Hall and Soskice's VoC approach has not been immune to criticism. Chief among these, the framework has been criticised for its 'very lack of variety' (with only two models of capitalism being distinguished by the authors),³⁵ and its neglect of the role of the state.³⁶ In Hall and Soskice's dualist approach, the role of the state is lumped together with other non-market-based institutions and does no more than 'inducing economic actors to cooperate more effectively with each other'.³⁷ This is mainly undertaken through state regulation and construction of mechanisms compatible with the institutional setting of the relevant type of capitalism.³⁸ The state is therefore neither an independent economic actor nor has objectives of its own. This 'weak state' conception is more consistent with the LME systems. This conception, however, has been widely criticised for its failure to distinguish different coordinative mechanisms at work in different CME systems.³⁹ As will be discussed later, some prime examples of a 'strong state', that have informed the identification of state capitalism as a distinct capitalist prototype, have been the post-war East Asian state-led economies or the 'developmental states'.⁴⁰

3.3 State capitalism and corporate governance

This chapter has so far considered the interrelationship between models of capitalism and corporate governance through reviewing Hall and Soskice's VoC approach. By bringing the role of the state into the institutional analysis, several approaches in the

³⁴ Nahee Kang and Jeremy Moon, 'Variations and Change in CSR from a Varieties of Capitalism Perspective' (Paper presented at the Oxford-Achilles seminar on CSR, Saïd Business School, University of Oxford, 11 February 2010) <www.xjjz.co.uk/.../Oxford-Achilles%20Seminar%20Paper%20-%20>.

³⁵ Nahee Kang, above n 10, 523; Colin Crouch, *Capitalist Diversity and Change: Recombinant Governance and Institutional Entrepreneurs* (New York, NY: Oxford University Press, 2005)1; Bob Hancke, Martin Rhodes and Mark Thatcher, 'Introduction' in Bob Hancke, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (Oxford University Press, 2007) 3, 7.

³⁶ Hancke, Rhodes and Thatcher, above n 35, 8; Chris Howell, above n 10, 110. In identifying the LME and CME dichotomy, Hall and Soskice did mention in passing a third type of capitalism which they labelled 'Mediterranean' but failed to theorise. This model includes countries such as France and Italy, Spain, Portugal and Greece. Noting the overly restrictive nature of LME and CME dichotomy, but remaining working within Hall and Soskice's framework, Hancke *et al* adopted the notion of 'Mixed Market Economies' to capture some central and Eastern European economies that combine certain elements of market, business networks with state-coordination. See Hall and Soskice, above n 2, 21; Hancke, Rhodes, and Thatcher, above n 35, 13-14.

³⁷ Hall and Soskice, above n 2, 45.

³⁸ *Ibid* 46.

³⁹ Hancke, Rhodes, and Thatcher, above n 35, 14-15.

⁴⁰ Schmidt, *The Futures of European Capitalism*, above n 7, 108-9.

VoC literature have gone beyond Hall and Soskice's LME/CME dichotomy by establishing state capitalism as a distinct capitalist prototype. As will be further explained below, through elucidating the interrelationship between different institutional domains, such as corporate governance, labour management and the role of the state in coordinating firm level activities in state-led economies, these studies have further identified a state-led model of corporate governance that may be distinguished from both the Anglo-American outsider-based and the German-Japanese (post-1980s) insider-based models.

Much of the analysis of state capitalism has been based on empirical work on the post-World War II state-led economies, known as the 'developmental states'. The term was first coined by Johnson, who saw the developmental state as a 'plan rational' state⁴¹ that combines the US-style private ownership of economy with the Soviet Union style state planning and guidance.⁴² The ownership of the economy largely remains in the hands of the private sector. The state, however, plays an active role in guiding the process of economic development and industrial transformation, using rigorous industrial policy and extensive policy tools to pick winners and losers.⁴³ The 'developmental state' has been primarily associated with the thirty-year post-war economic growth miracle in East Asia, particularly Japan, South Korea and Taiwan. The term, however, has also been used to explain state-led economic development in other countries such as France.⁴⁴ According to Radice, by around 1990, the notion of 'the development state' had become the 'main ideological rallying-point' for those challenging the Western free-market model as the ideal solution for developing countries.⁴⁵

Johnson's vision of the state-led economic development inspired a considerable body of literature that '[relates] economic performance to institutional arrangements centred on the state'.⁴⁶ This literature has been collectively labelled as the 'developmental state

⁴¹ Chalmers Johnson, *MITI and the Japanese Miracle: the Growth of Industrial Policy, 1925-1975* (Stanford University Press 1982) 17

⁴² Ibid 19; Chalmers Johnson, 'the Developmental State: Odyssey of a Concept', in Meredith Woo-Cumings (ed), *The Developmental State* (Cornell University Press, 1999) 32, 32.

⁴³ Johnson, *MITI and the Japanese Miracle: the Growth of Industrial Policy*, above n 41, 19; Alice H. Amsden, *Asia's Next Giant: South Korea and Late Industrialisation* (Oxford University Press, 1989).

⁴⁴ Michael Loriaux, 'The French DS as Myth or Moral Ambition' in Meredith Woo-Cumings (ed), *The Developmental State* (Cornell University Press, 1999) 235.

⁴⁵ Hugo Radice, 'The Developmental State under Global Neoliberalism' (2008) 29 *Third World Quarterly* 1153, 1153.

⁴⁶ Moon and Prasad define the developmental state theory as 'a collection of theories, descriptions and assertions which relate economic performance to institutional arrangements centered on the state'. See Chung-in Moon and

theory'.⁴⁷ Underlying most strands of this theory, such as Wade's 'governed markets',⁴⁸ Evans' 'embedded autonomy of the state',⁴⁹ and Weiss' 'governed interdependence',⁵⁰ is a strong state motivated by economic growth-oriented objectives and close relations between the state and businesses especially large businesses.⁵¹ Furthermore, often associated with the East Asian developmental states is a corporatist state-society relationship, characterised by an authoritarian state and weak civil society. State corporatism allows the state to act as a 'Janus-faced entity',⁵² that is, to privilege its ties with businesses, especially large businesses, on the one hand, while containing other societal groups, such as outsider investors, consumers and local communities (whose short term demands may not be consistent with long-term goals of the state) on the other.⁵³

This strong and centralised conception of the state in the developmental state theory has been reflected in several analytical frameworks developed by comparative capitalism scholars. As discussed below, by linking state capitalism with state-led corporate governance, these frameworks provide the micro corporate governance foundation for the theory of the development state.

Rashemi Prasad, 'Networks, Politics and Institutions', in Steve Chan, Cal Clark and Danny Lam (eds), *Beyond the Developmental State: East Asia's Political Economies Reconsidered* (St. Martin's, 1998) 9, 9.

⁴⁷ Ibid.

⁴⁸ In formulating this theory, Wade focused on the market guidance role of the state. See Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton University Press, 1992).

⁴⁹ Evans argued that while elite bureaucracy provides the state with the requisite autonomy, the state would have no means to obtain current information and support for formulation and implementation of economic policies without itself being sufficiently connected to businesses. See Peter Evans, *The Embedded Autonomy: States and Industrial Transformation* (Princeton University Press, 1995) 12.

⁵⁰ According to Weiss, in this relationship, government and businesses are more akin to equal partners in the process of economic development. Both the state and the private actor maintain their autonomy, but negotiate with each other and then work on agreed goals originally formulated and monitored by the state. See Linda Weiss, *The Myth of the Powerless State* (Polity Press, 1998) 34-39.

⁵¹ Kjeld Erik Brodsgaard and Susan Young, 'Introduction: State Capacity in East Asia' in Kjeld Erik Brodsgaard and Susan Young (eds), *State Capacity in East Asia* (Oxford University Press, 2000) 1, 3-4; Meredith Woo-Cumings, 'Introduction: Chalmers Johnson and the Politics of Nationalism and Development' in Meredith Woo-Cumings (ed), *The Developmental State* (Cornell University Press, 1999) 1, 16; Ha-Joon Chang, 'The Economic Theory of the Developmental State', in Meredith Woo-Cumings (ed), *The Developmental State* (Cornell University Press, 1999) 183, 192; Weiss, *The Myth of the Powerless State*, above n 50, 45. As highlighted by Evans, in post-war Japan, South Korea and Taiwan, this type of relations were reflected in the dense formal and informal networks that link government and large businesses in the processes of information exchange and policy formulation and implementation. See Evans, above n 49.

⁵² Woo-Cumings, 'Introduction', above n 51, 21

⁵³ Wade, above n 48, 27.

3.3.1 State capitalism as a capitalist prototype

The various frameworks, which have been developed by other comparative capitalism theorists to address the limitations of Hall and Soskice's approach, vary in their 'level of analysis, methodologies and the distinguishing traits of capitalism'.⁵⁴ They, however, share some common traits. Centrally concerned with corporate governance and labour relations, these alternative frameworks see an important role played by the state, among other factors such as norms, in shaping institutional configurations and actor behaviour.⁵⁵

One of the most influential typologies generated by these alternative frameworks has been Schmidt's classification of European capitalism. Schmidt distinguishes three types of capitalism in Europe from 1950s to 1980, namely, market (represented by Britain), managed (exemplified by Germany) and state-led (exemplified by the post-war France and to a lesser extent, Italy), which was based on her observation of the role of the state in three sets of business-centred relations (namely, business-business which include inter-firm relations and relations between industry and finance, business-government and industrial or labour relations).⁵⁶ While market capitalism and managed capitalism in this typology are akin to Hall and Soskice's LME and CME systems respectively, state capitalism may be differentiated from both type of systems, due to its high degree of state coordination of finance, state direction of management and state-coordination of employee relations.⁵⁷

⁵⁴ Casey, above n 5, 258.

⁵⁵ Jackson and Deeg, above n 6, 24; Casey, above n 54. Among scholars adopting the governance approaches, Amable grouped 21 advanced economies into five capitalist models, namely 'market-based', 'continental European', 'social democratic', 'Mediterranean' and 'Asian capitalism'. The 'Asian Model' in Amable's typology has been observed by Lane as a variant of the state-led capitalism previously characterised by Coates. In a similar vein, Boyer distinguished between four types of capitalism. These include a state-led model that revolves around the crucial role played by national, regional, or local state authorities in spheres such as production, industrial relations, competition and corporate finance. Furthermore, adopting a 'national business systems' approach to the study of diversity in national capitalist models, Whitley distinguished four ideal types of institutional regimes governing market economies, namely, 'arms' length', 'dominant developmental state', 'business corporatist' and 'inclusive corporatist'. The 'dominant developmental state' regime in Whitley's typology shares most of the key features of the state-led model developed by Schmidt, particularly state-managers relations and the influence of the state on firm interaction with employees and shareholders. See Bruno Amable, *The Diversity of Modern Capitalism* (Oxford University Press, 2003) 14. David Lane, 'Post-State Socialism: a Diversity of Capitalism?' in David Lane and Martin Myant (eds), *Varieties of Capitalism in Post-Communist Countries* (Palgrave, 2007) 13, 19; David Coates, 'Models of Capitalism' in the New World Order: the UK Case (1999) XLVII *Political Studies* 643, 651; Robert Boyer, 'How and Why Capitalism Differs' (2005) 34 *Economy and Society* 520, 530. Richard Whitley, *Business Systems and Organizational Capabilities: the Institutional Structuring of Competitive Competences* (Oxford University Press, 2007).

⁵⁶ Schmidt, *The Futures of European Capitalism*, above n 7, 112-8.

⁵⁷ Ibid 116-7; Vivien Schmidt, 'French Capitalism -Transformed, yet Still a Third Variety of Capitalism' (2003) 32 *Economy and Society* 526, 530.

Hence, in devising her framework, Schmidt viewed the state not only as an independent coordinator of economic activity (similar to the markets in the LME and corporate networks in the CME systems on the Hall and Soskice's model), but also as playing a distinctive role in different models of capitalism, that is, 'regulatory' in market capitalism, 'enabling' in managed capitalism and 'interventionist' or 'developmental' in state-led capitalism.⁵⁸ The characterisation of the role of the state in state-led capitalism as 'developmental' also allowed Schmidt to include East Asian developmental states, such as South Korea and Taiwan, in this model.⁵⁹ As discussed next, Schmidt's state-led capitalism has been interpreted as implying a state-led model of corporate governance.

3.3.2 State capitalism and corporate governance

State capitalism has been interpreted by comparative corporate governance scholars, such as Hansmann and Kraarkman and Kang, as being associated with a 'state-oriented' or 'state-led model' of corporate governance.⁶⁰ Rather than shareholder or stakeholder-oriented objectives, in this model, the economic development-oriented goals of the state are promoted, through insulating the 'top owner - managers from the short-term pressures – in the forms of return on investment and wage demands – which the stakeholders would otherwise have exerted on the firm in a more liberal setting'.⁶¹

This fundamental role has led to some distinctive features of corporate governance in state-led economies. As Kang and Moon pointed out, the state-led model shares many key features of the insider-based corporate governance in the CME systems. However, there is a critical difference between them. In the state-led model, the state, instead of corporate networks, plays the central role in coordinating firm interaction with its insider and outsider stakeholders, including managers, investors, employees and other stakeholders.⁶² The following features of corporate governance have been observed by various authors based on experiences of the post-war state-led economies.

State-manager relations in the state-led model have often been portrayed as very close. Some variations of this type of relations did exist in different state-led economies. For example, in post-war France, where state-ownership of large firms was prevalent,

⁵⁸ Schmidt, *The Futures of European Capitalism*, above n 7, 5; Kang, above n 10, 524.

⁵⁹ Schmidt, *The Futures of European Capitalism*, above n 7, 108-9.

⁶⁰ Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 446-7; Kang, above n 10, 533.

⁶¹ Kang, above n 10, 521.

⁶² *Ibid* 532.

government-business relationship was described by Schmidt as 'state-directed', with the government 'influencing business development through planning, industrial policy or state-owned enterprises'.⁶³ By contrast, in South Korea where the control of most *chaebols* (large family-controlled business groups) remained in the hands of their owner-managers, state-business relations were characterised as 'strong managerialism, but one that is infused with national interest'.⁶⁴ That said, state influence in major investment decisions of large firms appeared to be quite common in all former state-led economies. For example, in post-war Japan, in addition to state-controlled bank financing and various deliberating councils and industrial or trade associations that facilitated exchange of information and negotiation of interests between government and large businesses,⁶⁵ state intervention in business decision-making was carried out through 'administrative guidance' (information directions given by government ministries to large businesses) and the widespread practice of '*amakudari*', namely, 'descent from heaven' of retired bureaucrats to board positions in large private sector companies.⁶⁶ As many commentators on the East Asian developmental state and corporate governance have suggested, the presence of these dense government-business networks inevitably diminished the boundaries between the state and businesses.⁶⁷

In addition to close state-manager relations, state-led corporate governance has been associated with weak shareholder rights. This is because the state-led model assumes that outsider shareholders would have limited influence over company management decision-making, and would prioritise long-term shareholding over short-term profits.⁶⁸ For Hansmann and Kraakman, weak shareholder rights are an instrument of the state to perpetuate state control of corporate affairs. As the authors observed:

⁶³ Schmidt, *The Futures of European Capitalism*, above n 7, 116.

⁶⁴ As Kang put it, 'Within the broad confines of the state directives regarding large-scale investment decisions and production targets, the owner-managers enjoyed a significant degree of freedom.' See Kang, above n 10, 532.

⁶⁵ Weiss, *The Myth of the Powerless State*, above n 50.

⁶⁶ Curtis Milhaupt and Mark West, *Economic Organisations and Corporate Governance in Japan: the Impact of Formal and Informal Rules* (Oxford University Press, 2004) 16-17; Woo-Cumings, 'Introduction' above 51, 21; Meredith Woo-Cumings, 'Diverse Paths towards 'the right institutions': Law, the State, and Economic Reform in East Asia', in Linda Weiss (ed), *States in the Global Economy* (Cambridge University Press, 2003) 200, 206-10.

⁶⁷ See, eg, Mark Beeson, 'the Rise and Fall (?) of the Developmental State: The Vicissitudes and Implications of East Asian interventionism' in Linda Low (ed), *Developmental States: Relevancy, Redundancy or Reconfiguration?* (Nova Science Publishers Inc, 2004) 29, 31; Meredith Woo-Cumings, *The Developmental State* (Cornell University Press, 1999); Moon and Prasad, above n 46; Lilian Miles, 'Transferring the Anglo American System to South Korea: At What Cost, and Are There Alternatives?' (2008) 20 *Bond Law Review* 71, 71; Takeo Hoshi, 'Japanese Corporate Governance as a System', in Klaus K. Hopt et al (eds), *Comparative Corporate Governance: the State of the Art and Emerging Research* (Clarendon Press, 1998) 847, 868-9; Kong Yam Tan (ed), *Asian Economic Recovery: Policy Options for Growth & Stability* (World Scientific, 2002) 142, 145-6.

⁶⁸ Kang, above n 10, 532; Schmidt, *The Futures of European Capitalism*, above n 7, 116.

The principal instruments of state control over corporate affairs in corporatist economies generally lie outside of corporate law. They include, for example, substantial discretion in the hands of government bureaucrats over the allocation of credit, foreign exchange, licenses, and exemptions from anti-competition rules. Nevertheless, corporate law also plays a role by, for example, weakening shareholder control over corporate managers (to reduce pressures on managers that might operate counter to the preferences of the state) and employing state-administered criminal sanctions rather than shareholder-controlled civil lawsuits as the principal sanction for managerial malfeasance (to give the state strong authority over managers that could be exercised at the government's discretion).⁶⁹

Similar to the relations with outsider shareholders, company relations with other non-shareholder stakeholders in the state-led model are often dictated by the policy goals of the state. For example, state-led corporate governance in the post-war developmental states has been observed by commentators, such as Kang and Moon, as associated with a state-led model of corporate social responsibility.⁷⁰ On the one hand, the state may play an active role in promoting corporate social responsibility. On the other hand, the type of responsibilities promoted by the state rarely went beyond the promotion of labour peace and long-term employee commitments.⁷¹ Thus, in contrast to the high levels of employee protection, civil law suits from consumers and other corporate stakeholders against government and large companies were suppressed to the extent of non-existence.⁷²

The state-led model of corporate governance has lost much of its attraction since the late 1990s. Following the East Asian Financial Crisis of 1997, the strict loan conditions imposed by international financial institutions have compelled most of the former developmental states to move away from the state-led model in favour of the Anglo-

⁶⁹ Hansmann and Kraakman, above n 60.

⁷⁰ In doing so, they saw corporate social responsibility as a complementary institution to corporate governance. Nahee Kang and Jeremy Moon, 'Institutional Complementarity between Corporate Governance and Corporate Social Responsibility: a Comparative Institutional Analysis of Three Capitalisms' (2012) 10 *Socio-Economic Review* 85, 93-95; Jeremy Moon, Nahee Kang and Jean-Pascal Gond, 'Corporate Social Responsibility and Government in Western Europe and Northeast Asia from a National Governance Systems perspective' (International Centre for Corporate Social Responsibility Research Paper Series No. 56-2010) 11-13 <<http://www.nottingham.ac.uk/business/ICCSR/>>; Dirk Matten and Jeremy Moon, 'Implicit' and 'explicit' CSR: a Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' (2008) 33 *Academy of Management Review* 404, 408.

⁷¹ Nahee Kang and Jeremy Moon, 'Institutional Complementarity between Corporate Governance and Corporate Social Responsibility' above n 70, 94-95;

⁷² Frank Upham, 'Ideology, Experience and the Rule of Law' in Meredith Jung-en-Woo (ed), *Neoliberalism and Institutional Reform in East Asia* (Palgrave Macmillan, 2007) 35, 54. T. J Pempel, 'The Developmental Regime in a Changing World Economy', in Meredith Woo-Cumings (ed), *The Developmental State* (Cornell University Press, 1999) 140.

American outsider-based systems.⁷³ In a large body of literature reflecting on that Crisis, the developmental state has been generally equated with the deprecating term 'crony capitalism', in which state support for businesses led to 'corruption, nepotism and excessive bureaucratic rigidity', the precipitation of the Asian Financial Crisis.⁷⁴ Notwithstanding its various weaknesses, the significance of the state-led model of corporate governance to the thirty-year East Asian economic miracle should not be understated.

3.4 State capitalism and institutional change

If the 1997 Asian Financial Crisis could be viewed as some extreme pressure from outside the system ('external shock' in VoC terms),⁷⁵ to what extent and in what ways a strong and interventionist state may condition the interaction between changes in corporate governance, and socioeconomic changes, that fall short of such extreme pressure? As discussed below, these forces may come from both outside and the domestic society.

3.4.1 Forces for institutional change

First, economic globalisation, as manifested in the rapid internationalisation of the financial and product markets, has been widely considered as 'sweeping away all national differences in its path'.⁷⁶ The various models of capitalism worked relatively free from major international pressures until the early 1980s.⁷⁷ However, with the advent of globalisation, the international environments faced by companies in interacting with their internal and external stakeholders (including the state) have significantly altered.

For the radical globalists, at least before the recent Global Financial Crisis (GFC), globalisation leads to the convergence of national economic models, as all nation-states are forced to adopt a similar set of neo-liberal policies and practices.⁷⁸ In the area of

⁷³ Miles, above n 67; Ajit Singh and Ann Zammit, 'Corporate Governance, Crony Capitalism and Economic Crisis: Should the US Business Model Replace the Asian Way of 'Doing Business'?' (Centre for Business Research, University of Cambridge Working Paper, No.329. June 2006) 1 <www.cbr.cam.ac.uk/pdf/WP329.pdf>.

⁷⁴ Chalmers Johnson, *Economic Crisis in East Asia: The Clash of Capitalisms* (1998) 22 *Cambridge Journal of Economics* 653, 654; Brodsgaard and Young, above n 51, 6.

⁷⁵ Hall and Soskice, above n 2, 62.

⁷⁶ Schmidt, *The Futures of European Capitalism*, above n 7, 15-21; Jackson and Deeg, above n 6, 5, 38.

⁷⁷ Schmidt, *The Futures of European Capitalism*, above n 7, 107-9; Schmidt, 'French Capitalism' above n 57; Jackson and Deeg, above n 6, 5.

⁷⁸ Schmidt, *The Futures of European Capitalism* above n 7, 1.

corporate governance, as globalisation increases the free movement of capital, governments are under increasing pressures to conform to certain international standards of good corporate governance, namely the Anglo-American standards. This has led scholars, such as Hansmann and Kraakman, to predict the 'end of the history for corporate law'.⁷⁹

Nevertheless, globalisation has not been the sole pressure for convergence of national models of capitalism towards the free market model. The congruence between state-led economy and a corporatist type of state-society relationship has been discussed earlier. Associated with economic development and the global spread of neo-liberal ideas, the pluralisation of interests within domestic society may, however, significantly undermine the necessary foundation for a state-led system.⁸⁰ This is because pluralism sees the real source of good decision-making as lying in the participation of interest groups in a diversified civil society, rather than the state.⁸¹ The rise of pluralism may be caused by many factors, such as increased mobility of ordinary citizens, improved access to information technology and education,⁸² and the emergence of 'middle classes' that are 'no longer fully content with the blind acceptance of the hegemonic project of growth for its own sake'.⁸³ In the area of corporate governance, as diffused share ownership and institutional investment continue to grow, the rise of a public shareholder class has been seen as an important source of interest group influence.⁸⁴

3.4.2 Comparative capitalism and institutional change

Comparative capitalism has been criticised for failing to provide a satisfactory account for institutional change within given economic systems. The VoC scholars, such as Hall and Soskice, do not reject the idea that globalisation leads to institutional change, including change in national system of corporate governance.⁸⁵ Nonetheless, as noted by Jackson and Deeg, their notions of 'institutional complementarities' and

⁷⁹ Hansmann and Kraakman, above n 60, 439; Henry Hansmann, 'How Close Is the End of History?' (2006) 31 *Journal of Corporation Law* 745, 745.

⁸⁰ Brodsgaard and Yong, above n 51, 5.

⁸¹ Christopher Pierson, *The Modern State* (Routledge, 2004) 71-72.

⁸² Brodsgaard and Yong, above n 51, 5.

⁸³ Pempel, above n 72, 181.

⁸⁴ Hansmann and Kraakman, above n 60, 451-3.

⁸⁵ Hall and Soskice, above n 2, 54; Also see Peter Hall and Kathleen Thelen, 'Institutional change in varieties of capitalism' (2009) 7 *Socio-Economic Review* 7.

'comparative institutional advantages' provide strong disincentives for radical changes.⁸⁶

Most comparative capitalism scholars, including Hall and Soskice, believe that with the presence of 'institutional complementarities' (i.e., the mutually reinforcing effect of coherent institutions),⁸⁷ distinct institutional configurations provide '*comparative institutional advantage*'.⁸⁸ That is, different institutional configurations may have distinct strengths for particular types of activities.⁸⁹ In that sense, the comparative capitalism literature has also been interpreted as giving rise to a theory of '*institutional path dependence*'.⁹⁰ In the absence of extreme 'external shocks',⁹¹ institutional changes are likely to take place in an incremental fashion at best, allowing limited room for path-shifting changes.⁹²

Hall and Soskice's account of institutional change has been criticised by various researchers as overly static and deterministic.⁹³ These researchers called for more emphasis on explaining the dynamics of change. For example, pointing to Hall and Soskice's overemphasis on the effect of institutions, Crouch drew attention to the creative and innovative role played by actors, including the state, in bringing about radical changes.⁹⁴ As discussed next, relevant to the study of regulatory changes in Chinese corporate governance over the past few years, a more nuanced analysis has been provided by Milhaupt and Pistor.

3.4.3 Milhaupt and Pistor's exposition of the role of the state in conditioning law and economic changes

Milhaupt and Pistor's analysis was particularly relevant to the role of the state in changes in the formulation and implementation of law, including corporate governance

⁸⁶ Jackson and Deeg, above n 6, 37.

⁸⁷ Hall and Soskice, above n 2, 17.

⁸⁸ Ibid 37.

⁸⁹ Ibid 37-41. According to Hall and Soskice, while the LME systems are better at supporting industries dictated by radical innovation, firms in the CME systems are likely to prosper in industries that require incremental innovation. This is because compared to the CME systems, the combination of external shareholder markets and high level of fluid labour markets make it easier for firms in the LME systems to switch resources rapidly to new and profitable firms and business areas.

⁹⁰ Jackson and Deeg, above n 6, 5.

⁹¹ Hall and Soskice, above n 2, 62.

⁹² Jackson and Deeg, above n 6, 6.

⁹³ Hancke, Rhodes and Thatcher, above n 35, 7; Crouch, above n 35, 30-31; Jackson and Deeg, above n 6, 24, 37; Wailes, Kitay and Lansbury, above n 12, 19, 27; Jonathan Perraton, 'Varieties of Capitalism and Institutional Change', in (2007)24 *Comparative Social Research* 205, 248.

⁹⁴ Crouch, above n 35, 2-3.

rules, as a particular type of institution, in state-led economies. In their important book *Law and Capitalism* published in 2008,⁹⁵ using the formulation and implementation of corporate governance rules as an example, Milhaupt and Pistor considered the role of the state in the interrelationship between changes in law and economic changes in different types of legal systems which correspond to national economic models. In doing so, the authors divide six legal systems under their country case studies into 'centralised' and 'decentralised' systems, based on the degree of state coordination and state enforcement of legal rules.⁹⁶ The term 'state capitalism', or 'state-led economy', was not used in this book. However, its coincidence with the centralised systems can be deduced from the authors' frequent association of the centralised systems with countries generally considered as state-led economies, including Russia, China and 'other countries in East Asia that were traditionally characterised by strong government coordination such as South Korea'.⁹⁷

Unlike Hall and Soskice, whose VoC approach tends to see very limited room for institutional, including legal, change changes, Milhaupt and Pistor envisaged a highly interactive relationship between legal and market changes, described by the authors as the 'rolling relationship'.⁹⁸ As these authors put it, market changes of all types (such as technology changes and changes in the relative power of the economic actors) may create a demand for new law to address the uncertainty and restore equilibrium. Once the new rules are supplied by the law makers, they are taken up by the market players who use the rules to the limits in maximising their interests. This creates further issues of uncertainty that need to be addressed by law.⁹⁹ This 'rolling relationship' between law and markets can be intensified with increasing economic complexity and the globalisation of the markets, as actors who lack access to existing legal system demand for protection of their interests.¹⁰⁰

Nevertheless, according to Milhaupt and Pistor, this highly interactive process does not exclude the involvement of political economy, including the role of the state. This is especially so with centralised systems. In these systems, consistent with the role of the

⁹⁵ Milhaupt and Pistor, above n 1.

⁹⁶ Ibid 6. These seven countries are US, Germany, Japan, China, Singapore and Russia.

⁹⁷ Ibid, 147, 183, 187.

⁹⁸ Ibid, 28.

⁹⁹ Ibid.

¹⁰⁰ Ibid 42-43.

state as a chief coordinator of economic activity, the law primarily plays a coordinative function rather than protection of individual rights.¹⁰¹ By calling upon two important sets of tools in the formulation and enforcement of law, a strong state may exert significant control over the pace and extent of decentralisation of the country's legal system.

First, a highly centralised legal system provides the state with great leverage in determining the extent to which law may be contested by private actors.¹⁰² According to Milhaupt and Pistor, while a decentralised legal system tends to rely upon self-organised groups and individuals to mobilise the system, a highly centralised system favours 'state-vetted interest groups and actors'.¹⁰³ Where the law formulation and enforcement powers are allocated to a few key interest groups, those benefiting from the existing system are unlikely to press for radical changes. However, for the marginalised outsiders who have limited access to the law making and enforcement processes, their ability to voice demands for legal change can be significantly constrained.

Second, the state may substitute the demand for law from private actors with extra-legal devices such as norms.¹⁰⁴ Such non-legal alternatives may be preferred by both the state and private actors for various reasons. One reason is that they often offer cheaper and more effective solutions than legal means.¹⁰⁵ As the authors pointed out, the market players 'can be expected to opt out of the legal system whenever non-legal alternatives are available at lower economic or social cost to them'.¹⁰⁶ This is especially so with marginalised outsiders who are afforded little protection in the legal system.¹⁰⁷

Norms can also serve some other functions in state-led economies. As Pistor and Wellons suggested in their earlier study, from the perspective of an interventionist state, a legal system that allows a wide scope for norms to operate gives the state much discretionary power.¹⁰⁸ This idea can be reinforced by the close state-large business

¹⁰¹ Ibid 32-34.

¹⁰² Ibid 7.

¹⁰³ Ibid 8.

¹⁰⁴ Ibid 38-39.

¹⁰⁵ Ibid 40.

¹⁰⁶ Ibid 41.

¹⁰⁷ Ibid.

¹⁰⁸ Katharina Pistor and Philip Wellons, *The Role of Law and Legal Institutions in Asian Economic Development, 1960-1995* (Oxford University Press, 1999) 53.

relations in a state-led economy. For effective state-business collaboration to take place, the state bureaucracies need to have sufficient flexibility sustained by broadly-drafted laws.¹⁰⁹ Indeed, as pointed out by Milhaupt, at least prior to the Asian Financial Crisis, the important private benefits conferred by norms on the parties involved in the Japanese state-bank-large business coalition greatly tapered demand for corporate governance reform.¹¹⁰

By pointing to the tools that may be utilised by the state in centralised systems, Milhaupt and Pistor provide useful insights into the role of the state in shaping the pattern of legal change, including corporate law change, in state-led economies. The authors' analysis also shows that as these tools may be utilised in both the formulation and enforcement of law, while a rapid convergence of the law-in-books in state-led economies towards other systems is unlikely to occur, changes in the law-in-practice are likely to take place at an even slower pace. Substantial changes to the formal law may be introduced by the state in response to pressures from globalisation and interest group politics. Other devices, such as limitation of the contestability of law and norms, may, however, continue to operate in the implementation of changes in the formal law, and mitigate the effect of those changes. This is also consistent with Pistor and Wellons' findings in their earlier study of legal developments in six Asian economies. They found that different parts of those systems took different paths in development ('path differentiation' in the authors' term). While strong signs of convergence towards the Western model were present along the allocative dimension (that is, the contents) of the law, the procedural dimension, namely the application and enforcement of law, tended to be more path dependent.¹¹¹

However, focusing on the traditional instruments of an interventionist state as discussed above, Milhaupt and Pistor seem to have overlooked one other important set of tools that may be utilised by the state to shape legal changes in state-led economies. This set of tools can be found in market forces, including mechanisms from the decentralised

¹⁰⁹ Tom Ginsburg, 'Does Law Matter for Economic Development? Evidence from East Asia' (2000) 34 *Law and Society Review* 829, 837; According to Ginsburg, broad administrative discretion, based on broadly worded legislation, was one of the essential feature of the legal systems in Northeast Asian state-led economies from the early post-war period to the late 1980s. See also Tom Ginsburg, 'Law and the Liberal Transformation of the Northeast Asian Legal Complex' in Terrence Halliday, Lucien Karpik, and Malcolm Feeley (eds) *Fighting for Political Freedom* (Hart Publishing, 2007) 43, 48-49; See also Frank Upham, *Law and Social Change in Post-war Japan* (Harvard University Press, 1987).

¹¹⁰ For a detailed account of the operation of norms in Japanese corporate governance, see Curtis Milhaupt, 'Creative Norm Destruction: The Evolution of Nonlegal Rules in Japanese Corporate Governance' (2001) 149 *University of Pennsylvania Law Review* 2083, 2094.

¹¹¹ Pistor and Wellons, above n 108, 285.

systems. In Milhaupt and Pistor's analysis, the ever-intensification of market changes in centralised systems seems to be an unfortunate phenomenon that the state has to accept and tolerate, rather than providing an instrument for strengthening state capacity. The two dimensional legal system matrix developed by the authors appears to suggest that, as a centralised legal system continues to decentralise under growing market forces, much of its coordinative capacity will be lost and replaced by the protective function. This prediction is consistent with the authors' hypothesis of the 'rolling relations' between law and market changes. It, however, overlooks one important point: the coordinative capacity of the state and market forces are not necessarily mutually exclusive. Market forces can be used as an instrument to extend state power at least within certain limits. In other words, market forces can be seen as a double-edged sword. The growth of market forces will eventually constrain the room for the state to manoeuvre. However, within certain limit, with controlled decentralisation, the state may well utilise market forces, including elements of decentralised legal systems, to enhance its coordinative capacity.¹¹²

As states constantly adapt their instruments in response to changing market conditions in pursuit of policy goals,¹¹³ it is important to recognise this latter set of tools. Indeed, the capacity of an interventionist state to flexibly adapt has been emphasised by a number of scholars, in their attempt to formulate a 'new developmental state' in the aftermath of the Asian Financial Crisis. For example, Trubek argues that for a developmental state facing challenges of globalisation and competition, a more participatory approach to decision-making is necessary for the state to not only gather information and ideas from various societal groups, but also to mobilise broader social support.¹¹⁴ In a similar vein, Brodsgaard and Young argued that the need for reconciliation of pluralism with sufficient social unity forms an integral part of the task of the developmental state in maintaining a pro-growth environment. It is therefore necessary for the state to shift towards a more cooperative, participatory and equitable approach in its interaction with the wider society beyond businesses, although this may

¹¹² Linda Weiss, 'Is the State being "Transformed" by Globalisation?' in Linda Weiss (ed), *States in the Global Economy: Bring Domestic Institutions Back In* (Cambridge University Press, 2003) 293, 296-8.

¹¹³ *Ibid* 297.

¹¹⁴ David M Trubek, 'Developmental States and the Legal Order: Towards a New Political Economy of Development and Law' (University of Wisconsin Law School, Legal Studies Research Paper Series, Paper No.1075, October 2010) 10-12 <<http://ssrn.com/abstract=1349163>>; Also see Mark Robinson and Gordon White (eds), *The Democratic Developmental State: Political and Institutional Design* (Oxford University Press, 1998).

ultimately undermine the developmental state.¹¹⁵ Indeed, without seeing this enabling aspect of market forces, it is difficult to understand the position of the Singaporean system, treated by Milhaupt and Pistor as an 'anomaly' on their legal system matrix. The system was described by the authors as both highly coordinative (centralised) and protective (of individual rights).¹¹⁶ As will be illustrated in Chapters 6 to 8, this enabling aspect of market forces is also important to understand the role of the state in China's post-2005 regulation of corporate governance in listed SOEs.

One other point missing from Milhaupt and Pistor's analysis, which this thesis will seek to address, is the interaction between changes in law, including corporate governance law, with wider societal changes beyond economic changes. As noted earlier, Milhaupt and Pistor focused on the relationship between legal and economic changes which in turn leads to changes in the demand of economic (or market) players. As discussed in Chapter 2, this focus led the authors to conclude that Chinese corporate governance mainly perform a coordinative function, that is, a tool of the state to coordinate the interests of government agencies and key economic players involved in listed companies, such as their parent SOEs, the listed companies' managers and investors, particularly institutional investors. While these categories of players are important to corporate governance in China, a single focus on the interaction between law and economic changes ignores the evolution of Chinese corporate governance in response to demands made on the state for protection by other actors, such as non-shareholder stakeholders. Indeed, as will be discussed in Chapter 8, rapid societal changes that go beyond economic changes have also shaped the evolution of corporate governance in listed SOEs in China over the past few years.

3.5 Strengths and limitations of the framework

This chapter has so far set out a three-component theoretical framework for a state capitalism and institutional change approach to the analysis of China's post-2005 legal and regulatory reforms concerning the governance in listed SOEs. First, drawing upon literature on comparative capitalism, with Hall and Soskice's VoC approach in particular, this chapter has illustrated a well-established link between national economic and corporate governance models in the literature. Second, drawing upon scholarship in state capitalism, theory of the developmental state and studies of corporate governance

¹¹⁵ Brodsgaard and Young, above n 51, 5.

¹¹⁶ Milhaupt and Pistor, above n 1, 147, 183.

of the post-war state-led economies, the chapter has shown that state capitalism plays a major part in shaping the role and features of corporate governance in a state-led economy. Third, concerning the role of the state in conditioning the pace and direction of institutional change, particularly corporate governance change, in state-led economies, the chapter has shown that corporate governance in these economies will change over time, in response to pressures such as globalisation and the pluralisation of interests within society. The state, however, has an important role to play in these intertwined processes. This is especially so with centralised legal systems in which the state may employ multiple sets of tools, including market forces, in shaping the trajectory of changes in the formulation and implementation of corporate law. The employment of the multiple tools opens further the door for hybridisation of legal systems, with the centralised systems taking on elements of the decentralised ones. This, however, does not necessarily lead to a fundamental systemic transformation.

It is important to point out some limitations of this framework. First, in addition to the lack of variety and difficulty to account for change, the VoC literature has been criticised for its overemphasis on system cohesion and unity, while downplaying the conflicts and contradictions within and, among institutions.¹¹⁷ Indeed, the notion of a strong and autonomous state relied upon in the development state theory has been suggested by some commentators as a 'myth'.¹¹⁸ This is because this notion disguises the far more fractured nature of the state even in countries such as post-war Japan as the main empirical basis for the developmental state theory.¹¹⁹ Second, the state capitalism literature has also been criticised for its overemphasis on institutional arrangements at the national level, while underestimating dynamisms in state-business interactions at local levels.¹²⁰ Third, while the VoC literature, and Milhaupt and Pistor's law and capitalism analysis, have highlighted the distinctive institutional arrangements in state-led economies, these studies have largely ignored the quality of enforcement. The lack of an enforcement analysis may lead to the impression that 'actors somewhat voluntarily follow the formal and informal rules for normative, cognitive or material

¹¹⁷ Crouch, above n 35, 30-32; Moon and Prasad, above n 46, 11-12. According to McNally, this is especially so with transitional economies 'where institutional arrangements are in continuous flux'. See Christopher A. McNally, 'China's Capitalist Transition: The Making of a New Variety of Capitalism' (2007) 24 *Comparative Social Research* 177, 179.

¹¹⁸ Moon and Prasad, above n 46, 12; Sam Teffensen, 'The Weak State of Japan' in Kjeld Erik Brodsgaard and Susan Young (eds), *State Capacity in East Asia* (Oxford University Press, 2000) 17, 36.

¹¹⁹ Moon and Prasad, above n 46, 12; Sam Teffensen, above n 118.

¹²⁰ Moon and Prasad, above n 46, 17.

reasons'.¹²¹ The quality of enforcement is, however, a key element in explaining the divergence between the law-in-the-statute books and the law in practice. For example, illustrating the presence of a state-centric model of corporate social responsibility in China, Ho showed that various weaknesses associated with state-centred enforcement, including the lack of will and/or capacity of state agencies and government officials for legal enforcement, may have contributed to the lack of substantial changes in the reality of corporate social responsibility performance in China.¹²² Ho's analysis of the advantages and disadvantages of state-led reform of corporate social responsibility is discussed in Chapter 9.

Nevertheless, the three-component framework illustrated in this chapter serves the purpose of this research well for several reasons. First, as discussed earlier in this chapter, the framework provides a solid theoretical foundation for the interconnectedness between national systems of corporate governance, and their economic development models. Second, as discussed in chapter 2, without ignoring the possibility for the existence of a hybrid type of capitalism in China, state capitalism captures the dominant economic development model in China. And third, as the discussion of state capitalism and institutional change in section 3.4 suggested, a state-led capitalism approach to the governance of Chinese listed SOEs does not need to ignore the international and domestic dynamics for change at work.

Given these limitations of comparative capitalism as an analytical framework, it is conceivable that the governance practice in each listed SOE is likely to be more diversified than the stylised account provided in this thesis. However, the main objective of this thesis is to explore a conceptual model that may have emerged from China's post-2005 legal and regulatory reforms of corporate governance in listed SOEs. This objective necessitates a focus on principles and structures of corporate governance at the national level, rather than the nuanced differences among individual companies in different localities.

¹²¹ Natalia Boliari and Kudret Topyan, 'Conceptualizing Institutions and Organizations: A Critical Approach' (2007) 5 *Journal of Business and Economic Research* 1, 7.

¹²² Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375, 432.

3.6 Conclusion

This chapter has outlined the theoretical framework for a state capitalism and institutional change approach to the interpretation of corporate governance development in Chinese listed SOEs. Despite its various limitations, this framework serves the purpose of this research for a number of reasons, including that it captures the dominant economic development model in China without ignoring the international and domestic forces for change faced by Chinese corporate governance.

Different components of the framework will be employed in this research in the following ways. The first two elements, namely, the linkages between national models of capitalism and corporate governance, and between state capitalism and the state-led model of corporate governance, will be utilised to examine the rationale behind the official adoption of the concept of corporate governance in China during the course of Chinese SOE reform (the first set of subsidiary research questions to be discussed in Chapter 4). These two elements will also be used to analyse the main features of and problems with corporate governance in Chinese listed SOEs prior to the 2005 corporate law reforms (the second set of subsidiary research questions to be discussed in Chapter 5). To identify and interpret the model of corporate governance derived from China's post-2005 regulation of corporate governance in listed SOEs (the third set of subsidiary research questions to be addressed in Chapters 6 to 8), this thesis will draw upon and extend Milhaupt and Pistor's analysis of the role of the state in conditioning legal and economic changes in state-led economies.¹²³ In doing so, this thesis will illustrate market-based corporate governance mechanisms and international best practices as a set of tools that have been utilised by Chinese policy makers to refract pressures and strengthen the coordinative capacity of the state to retain state-led corporate governance.

Finally, to assess the impact of China's post-2005 legal and regulatory reforms on the reality of corporate governance in listed SOEs (the fourth set of subsidiary research questions to be addressed in Chapter 9), this thesis will draw upon Ho's analysis of the relative advantages and disadvantages of state-led reforms of corporate social responsibility¹²⁴ to supplement Milhaupt and Pistor's theorisation. Chapter 4 proceeds

¹²³ Milhaupt and Pistor, above n 1.

¹²⁴ Ho, above n 122, 431-8.

by examining the history behind China's official adoption of the concept of corporate governance.

4.1 Introduction

This chapter traces the official adoption of the concept of corporate governance in China. As discussed in Chapter 2, comparative corporate governance studies often use the Anglo-American outsider-based model as the benchmark for assessing corporate governance in Chinese listed state-owned enterprises (SOEs). In doing so, they appear to assume that Chinese policy makers had adopted the Anglo-American concept of corporate governance for the same shareholder-oriented objectives as China embarked on corporatization of SOEs in the early 1990s. However, in setting out the theoretical framework for this study, Chapter 3 showed that rather than merely transplanting Anglo-American shareholder-oriented corporate governance to a state-led economy in order to promote economic development through international trade and investment with large enterprises, as such, the analysis of the evolution of corporate governance in listed SOEs in China requires two fundamental questions to be addressed: (i) *Why did Chinese policy makers embrace the concept of corporate governance?* (ii) *How was the actual concept understood?*

To answer these two questions, this chapter reviews China's 30-year SOE reform policy in its official introduction of the corporate governance concept in 1999. Chinese SOE reform before this year may be divided into two stages. The initial stage (1978-1992) was characterized by expanding managerial autonomy and incentives within the established system of state ownership at enterprise level. The second stage, which began with the Third Plenum of the 14th Central Committee of the Party in November 1978, and lasted till the early 2000s, focused on the transformation of traditional State-owned large corporations and rationalizing the state sector. As will be discussed in Chapter 4, this trend of institutional reform of SOEs has continued during the third (and current) reform stage. This latter stage, which had its inception in the 16th Party's National Congress in 2002 (and the subsequent establishment of the State-owned Assets Supervising and Administration Commission (SASAC) in early 2003), has been mainly focused on reforming the system for management of state-owned assets. A timeline for Chinese SOE reform over the past three decades is at Appendix 4-1.

CHAPTER 4 OFFICIAL ADOPTION OF THE CONCEPT OF CORPORATE GOVERNANCE IN CHINA

4.1 Introduction

This chapter traces the official adoption of the concept of corporate governance in China. As discussed in Chapter 2, comparative corporate governance researchers often use the Anglo-American outsider-based model as the benchmark for assessing corporate governance in Chinese listed state-owned enterprises (SOEs). In doing so, they appear to assume that Chinese policy makers had adopted the Anglo-American concept of corporate governance for the same shareholder-oriented objectives, as China embarked on corporatisation of SOEs in the early 1990s. However, in setting out the theoretical framework for this study, Chapter 3 showed that rather than merely maximising financial returns to shareholders, corporate governance in a state-led economy is often an instrument of the state to promote economic development through intervention in and/or coordination with large businesses. As such, the analysis of the evolution of corporate governance in listed SOEs in China requires two interrelated questions to be addressed: why did Chinese policy makers embrace the concept of corporate governance? And what was the actual concept embraced?

To answer these two questions, this chapter reviews China's 20-year SOE reform prior to the official introduction of the corporate governance concept in 1999. Chinese SOE reform before that year may be divided into two stages. The initial stage (1979-1992) was characterised by expanding managerial autonomy and incentives within the established system of state ownership of enterprises. The second stage, which began with the Third Plenum of the 14th Central Committee of the Party in November 1993, and lasted till the early 2000s, focused on the transformation of traditional SOEs into large corporations and rationalising the state sector. As will be discussed in Chapter 6, this trend of institutional reform of SOEs has continued during the third (and current) reform stage. This latter stage, which had its inception in the 16th Party's National Congress in 2002 (and the subsequent establishment of the State-owned Assets Supervision and Administration Commission (SASAC) in early 2003), has been mainly focused on reforming the system for management of state-owned assets. A timeline for Chinese SOE reform over the past three decades is at Appendix 4-1.

Through reviewing the first two stages of SOE reform, this chapter will show that instead of the Anglo-American shareholder-oriented objectives, the concept of corporate governance in China was adopted mainly to raise the efficiency of corporatised SOEs through improving their management. Although the concept had been promoted by academics inside China since the early 1990s, official adoption of the concept did not occur until the late 1990s, when a number of other measures to reform loss-making SOEs had been tried, but achieved limited success.

Through examining the actual wording of the concept that first appeared in a 1999 Party policy document on the reform and development of SOEs,¹ this chapter will also show that the concept of corporate governance originally embraced by Chinese policy makers was primarily concerned with improving management of corporatised SOEs through solving the agency problem between the state and corporate managers without removing ultimate state control. As such, in contrast to its Anglo-American counterpart, the concept embraced by Chinese policy makers was a state-centred one.

As will be demonstrated in Chapters 6 and 7, this concept of corporate governance has since evolved. The concept has been enlarged with the incorporation of more investor and other stakeholder-friendly principles and structures into Chinese regulatory framework. However, the fundamental role of corporate governance in promoting economic-oriented policy goals has largely remained the same. In that sense, the concept continues to align the governance of listed SOEs in China with the former post-war state-led model.

4.2 Official adoption of the concept of corporate governance

As a matter of socialist ideology and economic practicability, China strictly followed a Soviet-style centrally planned economy after the founding of the People's Republic of China (PRC) in 1949. By 1954, almost all Chinese enterprises had become wholly state-owned, with their primary function dedicated to implementing state compulsory plans, and their needs for funds met by budgetary grants. This state-owned and state-run system meant that SOEs had little vitality. Towards the end of 1970s, the whole Chinese

¹ 《中共中央关于国有企业改革和发展若干重大问题的决定》[Decision of the Central Committee of the Chinese Communist Party on Several Major Issues Concerning the Reform and Development of State-owned Enterprises], Adopted at the Fourth Plenum of the 15th Central Committee of the Chinese Communist Party, 22 September 1999 ('1999 Decision').

industrial economy was on the verge of bankruptcy, which propelled the policy makers to embark on a course of market-oriented reforms.²

4.2.1 Initial reform efforts

Initial reform measures focused on improving the operational mechanisms through expanding managerial autonomy without disturbing the system of state ownership of enterprises. This was in part due to the political and ideological constraints associated with privatisation of SOEs, and, in part, that the policy makers did not have a blueprint at the outset of the reform.³ As suggested by Wu Jinglian, a leading Chinese economist, a basic diagnosis of the problems of SOEs led to the belief that separating state ownership from control of enterprises, without abandoning the basic institutional framework, could be the solution.⁴

Hence, guided by the principle of separation of state ownership from control, initial reform measures saw SOE managers granted a wide range of operational decision-making powers, spanning production planning, employee recruitment, wages and bonuses, and imports and exports.⁵ To provide managers with additional incentives to maximise profits, an 'enterprise contract responsibility system' was also introduced during the second half of the 1980s.⁶ Under this system, business operations in most industrial and commercial SOEs were contracted to their management or top managers.⁷ After fulfilling the contract terms including paying to the government a fixed amount or

² In 1978, China had 83,000 SOEs and a large number of urban and rural collectives. The output value of the state-owned industrial enterprises accounted for 80.80 per cent of the total industrial output in China. For commentaries on PRC SOEs in their pre-reform stage, see Yiping Huang and Ronald Duncan (eds) *Reform of State-owned Enterprises in China: Autonomy, Incentive and Competition* (Asia Pacific Press, 1998).

³ Tony Saich, *Governance and Politics of China*, (Palgrave Macmillan, 2nd ed, 2004) 242.

⁴ Wu Jinglian, *Understanding and Interpreting Chinese Economic Reform* (Thomson South-Western, 2005) 142.

⁵ From 1979 to the early 1990s, a series of regulations were passed by the central government to grant various operational rights to enterprise managers. See, eg, 《关于扩大国营工业企业经营管理自主权的若干规定》[Several Regulations on the Expansion of Operational and Managerial Autonomy of State-run Industrial Enterprises] (People's Republic of China) State Council, 13 July 1979; 《关于提高国营工业企业固定资产折旧率和改进折旧费使用办法的暂行规定》[Provisional Regulations on Increasing the Depreciation Rate of Fixed Assets in State-run Enterprises and Improving the use of Depreciation Payments] (People's Republic of China) State Council, 13 July 1979; 《关于进一步扩大国营工业企业自主权的暂行规定》[Interim Regulations on Further Expanding the Autonomy of State-owned Industrial Enterprises] (People's Republic of China) State Council, 10 May 1984; 《全民所有制工业企业转换经营机制条例》[Regulations on the Transformation of the Operational Mechanism of the Enterprises Owned by the Whole People] (People's Republic of China) State Council, 30 June 1992.

⁶ 《关于深化企业改革，增强企业活力的若干决定》[Several Decisions on Deepening Enterprise Reform and Invigorating Enterprise Vitality] (People's Republic of China) State Council, 5 December 1986.

⁷ By the end of 1988, about 95 per cent of SOEs adopted the enterprise contract responsibility system. See 中央财经领导小组办公室 [Office of the Communist Party Central Finance and Economic Committee], 《中共中央关于国有企业改革和发展若干重大问题的决定学习辅导讲座》[Speeches on Studying the Decision of the Central Committee of the Communist Party of China on Several Major Issues Concerning the Reform and Development of State-owned enterprises] (人民出版社 [People's Publishing House], 1999) 35.

percentage of profits, these managers were allowed to retain the surplus to reward themselves and employees.⁸ To further encourage decentralisation of state power to enterprise managers and profit sharing between the state and enterprises, the principle of separation of state ownership and control of SOEs was codified by the *Law on Industrial Enterprises Owned by the Whole People* enacted in 1998.⁹ The 1998 *Law* also created the legal person status for SOEs¹⁰ for the first time, and required a 'factory top manager responsibility system' to be implemented in all industrial SOEs.¹¹

The various managerial autonomy expansion-oriented measures adopted during this initial stage of SOE reform were complemented by reforms in other areas. These included the replacement of budgetary grants with state bank loans (which further laid the foundation for the reform of Chinese banking and financial sector that began in 1993),¹² and the introduction of enterprise income tax to replace the profit remission system.¹³ A dual-track (plan and market) pricing system was also introduced, which allowed SOEs to sell to the markets their above-plan outputs.¹⁴ Furthermore, from the late 1970s, the central government allowed the non-state sector, comprising collective, private and foreign-invested enterprises, to develop alongside SOEs. The rapid growth of the non-state sector imposed additional pressure on SOEs to reform and improve their performance.¹⁵

⁸ 《全民所有制工业企业承包经营责任制暂行条例》[Interim Regulations on Contract Management Responsibility System in Industrial Enterprises Owned by the Whole People] State Council, 27 February 1988, art 8.

⁹ 《全民所有制工业企业法》[Law on Industrial Enterprises Owned by the Whole People] (People's Republic of China) National People's Congress, 13 April 1988, art 2(2); Wu Jinglian, above n 4, 152.

¹⁰ 《全民所有制工业企业法》[Law on Industrial Enterprises Owned by the Whole People] art 2(3).

¹¹ Ibid art 7.

¹² Yun Chen, *Transition and Development in China: Towards Shared Growth* (Ashgate, 2008) 132. The four major state-owned banks, as in 1994, were Bank of China, Industrial and Commercial Bank of China, China Construction Bank and Agricultural Bank. The implementation of the policy of separation of policy and commercial banks led to the establishment of several policy banks such as China Development Bank, Agricultural Development Bank and China Imports-export Bank were established in 1994.

¹³ For the first step, SOEs were also allowed to retain a share of profits and to sell above plan output. The Regulations on Enterprise Income Tax was finally introduced by the State Council in 1993. 《企业所得税暂行条例》[Interim Regulations on Enterprise Income Tax] (People's Republic of China) State Council, 26 November 1993.

¹⁴ Doug Guthrie, *China and the Globalisation* (Routledge, 2006) 45-46.

¹⁵ Leng Jing, *Corporate Governance and Financial Reform in China's Transition Economy* (Hong Kong University Press, 2009) 44.

These initial reform efforts produced some mixed results.¹⁶ One of the most significant achievements, as Naughton pointed out, was that they allowed the command system to be gradually eroded without ‘a catastrophic economic decline’.¹⁷ However, the lack of efficiency of SOEs persisted, due in part to ambiguity in the construction of their rights and responsibilities. As the administrative power over these enterprises remained fractured among various government agencies at central and local levels, the expansion of managerial decision-making did not prevent bureaucratic interference in the affairs of enterprises.¹⁸ Nor did the ‘enterprise contracting system’ meet the expectation of policy makers, as ‘managers and workers only took the upside of profit increases’, but were unable to bear the consequences of their failures.¹⁹ Furthermore, the short-term nature of the management contracts encouraged managerial opportunism in various forms, ranging from relentless pursuit of production outputs while neglecting inputs to outright stripping of enterprise assets.²⁰ From 1986, the need to improve the efficiency of SOEs, and to expand their equity financing, propelled the central government to pilot the Western idea of corporatisation in selected cities and enterprises.²¹ This further paved the way for the second stage of Chinese SOE reform, namely, the transformation of traditional SOEs into corporations and the rationalisation of the state sector.

4.2.2 Corporatisation, partial listing and restructuring the state sector

The second stage of SOE reform had its inception at the Third Plenum of the 14th Central Committee of the Party in 1993, which also marked a turning point in China’s approach to its overall economic reform. At the Third Plenum, the Party decided to establish a ‘socialist market economy’, defined as ‘giving the basic role of allocation of resources to the market forces but under state macroeconomic control’ (the 1993

¹⁶ Andrew Yuen and Aning Zhang, ‘An Economic Perspective on Recent Corporate Governance Developments in China with Comments on Chapters by Yang, Gu and Wang’ in Masao Nakamura (ed), *Changing Corporate Governance Practices in China and Japan* (Palgrave macmillan, 2008) 63, 64.

¹⁷ Barry Naughton, *The Chinese Economy: Transitions and Growth* (The MIT Press, 2006) 325.

¹⁸ 马俊驹 [Ma Junju] 《现代企业法律制度研究》 [A Legal System for Modern Enterprises] (法律出版社 [China Law Press], 2000) 52.

¹⁹ Leng, above n 15, 42-43.

²⁰ 中央财经领导小组办公室 [Office of the Communist Party Central Finance and Economic Committee], above n 7, 20; Jian Chen, *Corporate Governance in China* (RoutledgeCurzon, 2005) 39.

²¹ Ross Garnaut, Ligang Song, Yang Yao, ‘Impact and Significance of State-Owned Enterprise Restructuring in China’ in Belton Fleisher et al (eds), *Policy Reform and Chinese Markets: Progress and Challenges* (Edward Elgar, 2008) 38, 40; 《关于深化企业改革，增强企业活力的若干决定》 [Several Provisions on Deepening the Enterprise Reform and Enhancing Enterprise Vitality] (People’s Republic of China) State Council, 5 December 1986. This document allowed local governments to select large to medium-sized local SOEs to pilot the shareholding system.

Decision).²² As such, as noted in Chapter 2, the 'bottom-up' approach employed in the first stage of SOE reform, based on gradualism, experimentalism and decentralisation, gave way to a more 'top-down' approach that focused on capacity building of the central state and development of large SOEs.²³

At the same Plenum, the Party also announced that the 'modern enterprise system', essentially the corporate system, was to be established in SOEs.²⁴ The system was considered a crucial component of the 'socialist market economy', and was described as having the following four major aspects: (1) clearly established property rights; (2) clearly-defined powers and responsibilities (among parties involved in the management of SOEs, so that each enterprise could be genuinely responsible for its own profit and losses); (3) separation of enterprise from government, and (4) scientific management.²⁵

This description of the 'modern enterprise system' has been regarded by some Anglo-American researchers as the official endorsement of the Western concept of corporate governance in China. For example, in a World Bank commissioned report in 2002, Tenev *et al* saw the concept of 'modern enterprise system' entail:

[t]he corporate structure, governance, and management based on the principle of corporatisation, and with the provisions for full separation of the state's exercise of ownership rights from the enterprises' exercise of legal person property rights.²⁶

A similar observation was also made by Tam, who believed that the policy emphasis of the 'modern enterprise system' was 'on establishing a desired form of arrangements for corporate governance'.²⁷

However, according to Wu Jinglian, the 1993 *Decision* did not 'give a specific definition for modern corporate governance'.²⁸ As the reinvigoration of SOEs through separation of state ownership and control of enterprises continued to dominate the

²² 《中共中央关于建立社会主义市场经济体制若干问题的决定》[Decision of the Central Committee of the Chinese Communist Party on Some Major Issues Concerning the Establishment of the System of Socialist Market Economy], Adopted at the Third Plenum of the 14th Central Committee of the Chinese Communist Party, 14 November 1993 ('1993 *Decision*').

²³ Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (Cambridge University Press, 2008) 168-9; 1999 *Decision*, above n 1.

²⁴ 1993 *Decision*, above n 22.

²⁵ *Ibid.*

²⁶ Stoyan Tenev and Chunlin Zhang with Loup Brefort, *Corporate Governance and Enterprise Reform in China* (The World Bank and the International Finance Corporation, 2002) 16.

²⁷ On kit Tam, *The Development of Corporate Governance in China* (Edward Elgar, 1999) 7.

²⁸ Wu Jinglian, above n 4, 152.

thinking of policy makers, the 1993 *Decision* focused more on corporatisation as a tool to expand the autonomy of SOEs, rather than the actual governance of these enterprises.²⁹

Indeed, as pointed out by some other Chinese commentators, including Zhou Xiaochuan, former Chairman of the China Securities Regulation Commission (CSRC), the term 'corporate governance' was not officially adopted by the Party until 1999.³⁰ This notion, if it was present at all in the minds of Chinese policy makers at the onset of the corporatisation reform, was nothing more than 'promotion of higher efficiency through better management'.³¹ As discussed in section 4.3, the subsequent adoption of the concept by the Party was for a similar purpose.

As corporatisation was officially endorsed as the new direction for the reform of SOEs, a number of more specific measures were quickly implemented. First, from 1994, the central government selected 100 large SOEs to pilot the modern enterprise system.³² Another 2600 SOEs were also selected by local governments. This was followed by the Party's call to establish the 'modern corporate system' in all large and medium-sized SOEs in 1997.³³ Second, the first PRC *Company Law*³⁴ was introduced in 1993 to facilitate corporatisation of SOEs, and to provide the 'legal underpinnings for the concept of a modern enterprise system'.³⁵ The *Company Law* provided three types of companies that could be utilised by incorporated SOEs, namely, wholly-state owned companies, limited liability companies (with no more than 50 shareholders, similar to the definition of proprietary companies under the Australian *Corporations Act 2001*

²⁹ 吴晓波 [Wu Xiaobo] 《吴敬琏传》 [The Biography of Wu Jinglian] (中信出版社 [CITIC Publishing House], 2010) 76.

³⁰ 中国人民银行行长周小川 [People's Bank of China President Zhou, Xiaochuan], '完善上市公司治理 推进资本市场发展' [Improving Corporate Governance of Listed Companies to Promote Development of the Capital Market] (Speech delivered at the China Forum: Capital Market and Corporate Governance, 1 December 2004) <<http://www.china.com.cn/chinese/OP-c/718350.htm>>; Also see Jane Fu, *Corporate Disclosure and Corporate Governance in China* (Kluwer Law International, 2010) 4.

³¹ Donald Clarke, 'Corporate governance in China: An Overview' (2003) 14 *China Economic Review* 494, 497; Roman Tomasic and Jenny Jianrong Fu, 'Government-owned Companies and Corporate Governance in Australia and China: Beyond Fragmented Governance' (2006) 3 *Corporate Ownership and Control* 123, 124.

³² 马俊驹 [Ma Junju], above n 18, 57.

³³ 江泽民 [Jiang Zemin], 《在中国共产党第十五次全国代表大会上的报告》 [Report at the 15th Congress of the Chinese Communist Party] (12 September 1997) <<http://cpc.people.com.cn/GB/64162/64168/64568/65445/4526285.html>>.

³⁴ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993 ('1993 PRC Company Law').

³⁵ Tenev and Zhang with Brefort, above n 26.

(Cth)³⁶), and joint stock companies (similar to the public companies under the *Australian Corporations Act*³⁷). It also specified the corporate organs, including the general meeting, the board of directors and the board supervisors, and stated their respective functions within each type of company. Third, the Shanghai and the Shenzhen Stock Exchanges were established in 1990 and 1991 respectively. In 1998, the two exchanges were taken over by the CSRC from their local governments to 'serve better the needs of the nation'.³⁸ As will be further illustrated in Chapter 5, the two stock exchanges, as subdivisions of the CSRC, have since served as a main source of equity financing for reforming SOEs. In a similar vein, the first PRC *Securities Law* was enacted in 1998.³⁹

As stated above, the purpose of corporatisation of SOEs was not privatisation. Therefore, a split share structure was devised to allow the state to retain a controlling shareholding in most joint stock companies which had been converted from SOEs. Under this scheme, shares in incorporated SOEs were divided into three types according to the nature of ownership: namely, state shares, (state) legal person shares and individual or public shares.⁴⁰ State shares are shares converted from the total assets of the former SOEs, and vested in responsible government departments or authorised state investment bodies. The latter include parent SOEs of large state-owned enterprise groups authorised by the State Council to hold shares in their subsidiaries on behalf of the state. Legal person shares are shares acquired by SOEs with their own capital. Only individual shares issued to the public were allowed to be traded on stock exchanges.⁴¹ Hence, the state, through state and state legal person shares, retained about two thirds of non-tradeable shares in the vast majority of listed companies. Indeed, under the 1993 *Company Law*, non-tradeable shares in a listed company could amount to up to 85 per

³⁶ *Corporations Act 2001* (Cth) s 113 (1).

³⁷ *Ibid* s112 (1).

³⁸ Jian Chen, above n 20, 35.

³⁹ 《中华人民共和国证券法》[Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress, 29 December 1998.

⁴⁰ The distinction between state, state legal person and individual shares has been stipulated in a number of official documents, eg, 《股份制企业试点办法》[Measures on the Experiment of Joint Stock Companies] (People's Republic of China) State System Reform Commission, State Planning Commission, Ministry of Finance, People's Bank of China and State Council Production Office, 15 May 1992.

⁴¹ *Ibid*.

cent, where the company had a registered capital above RMB400 million (approximately AUD66 million).⁴²

Concentrated share ownership in listed SOEs was also contributed to by a system of quota control over public issue of shares and partial listing of parent SOEs. The system of quota control was introduced in 1994, and was designed to ensure the quality of Chinese listed companies by creating incentives for central and local authorities to bring the best companies onto the stock market.⁴³ Under the system, annual share issue quotas were allocated to different provincial governments and ministries. This, however, encouraged the latter to grant quotas primarily to SOEs under their control rather than enterprises in the private sector.⁴⁴ Nevertheless, riddled with bad debts and non-performing loans, the vast majority of SOEs could hardly satisfy the criteria of three consecutive years' profits for listing set in the 1993 *Company Law*.⁴⁵ Thus, rather than listing the parent enterprise, most SOEs took advantage of a concession offered by the *Company Law* that allowed issuers restructured from SOEs to use pro-forma profit records,⁴⁶ and split a profitable line of business or 'dressed up' an existing subdivision for the specific purpose of listing.⁴⁷ This practice was also encouraged by the central government, because it was regarded as a practical solution to the problem of SOEs.⁴⁸

The concentrated ownership structure in listed SOEs has since continued. This is despite the removal of the quota system in late 2000, and the 'split share structure reform' in 2005 that converted all non-tradeable shares into tradeable shares.⁴⁹ A listed SOE is usually controlled by an unlisted, and typically wholly state-owned, parent SOE.

⁴² 1993 PRC *Company Law* art 152(4).

⁴³ Katharina Pistor and Chenggang Xu, 'Governing Emerging Stock Markets: Legal vs. Administrative Governance' (2005) 13 *Corporate Governance: An International Review* 5, 8.

⁴⁴ Yuwa Wei, 'China's Capital Market and Corporate Governance: the Promotion of the External Governance Mechanism' (2007) 4 *Macquarie Journal of Business Law* 325, 337.

⁴⁵ 1993 PRC *Company Law* art 152(3)

⁴⁶ Ibid art 152(3).

⁴⁷ Tenev, Zhang with Loup Brefort, above n 26, 75.

⁴⁸ See, eg, 1999 *Decision* above n 1; 《关于深化大型企业集团试点工作的意见》 [Opinions on Deepening the Experiment with Large Enterprises Groups] (People's Republic of China) State Planning Commission, the State Economic and Trade Commission and the State System Reform Commission, 8 April 1997. Similar Guidelines have also been issued by provincial governments.

⁴⁹ 《关于上市公司股权分置改革试点有关问题的通知》 [[Notice on Relevant Issues concerning the Pilot Reform of Split Share Structure in Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 29 April 2005, s 3 (4); 《关于上市公司股权分置改革的指导意见》 [Guiding Opinion on Reforming the Split Share Structure in Listed companies] (People's Republic of China) China Securities Regulatory Commission, State-owned Assets Supervision and Administration Commission, Ministry of Finance, People's Bank of China and Ministry of Commerce, 23 August 2005.

Indeed, as Chapter 5 will illustrate, group affiliation was one of the main factors affecting the governance practice in listed SOEs prior to the 2005 corporate law reforms.

During the second stage of the SOE reform, a process that went hand-in-hand with corporatisation was the state-led formation of large state-controlled enterprise groups.⁵⁰ With the trial of corporatisation underway, the Party soon realised that it was not beneficial either economically or practically for the State to retain ownership in the majority of SOEs. By 1996, there were approximately 305,000 SOEs in China.⁵¹ However, the largest 1000 accounted for about two-thirds of the total assets held by all industrial SOEs and more than 70 per cent of sales revenue, profits, and tax receipts of all SOEs in China.⁵² The remainder of the state sector was permeated by 'too many too small' enterprises, exacerbating the overall inefficiency of the Chinese industrial economy.⁵³

Hence, at the Fifth Plenum of the 14th Central Committee of the Party in September 1995, the Party announced a policy to reorganise the state sector by following the principle of 'grasping the large and letting go of the small' (*Zhuada Fangxiao*).⁵⁴ This meant that the state would set free the small SOEs through various means, from leasing to full privatisation. It would, however, retain control of the large ones and transform them into 'highly competitive modern enterprise groups'.⁵⁵ The subsequently released national Ninth Five-Year Plan (1996-2000) stated that the central government would 'grab and re-invigorate' 1,000 large SOEs to be selected.⁵⁶ Provincial governments were also called upon to grasp and develop their local key SOEs.⁵⁷ Apart from

⁵⁰ As Wei observed, the SOE reform "enabled the government to corporatise SOEs on one hand, and assemble them into corporate groups on the other". Yuwa Wei, *Comparative Corporate Governance, A Chinese Perspective* (Kluwer Law International, 2003) 60.

⁵¹ The World Bank, *China's Management of Enterprise Assets: The State as Shareholder* (The World Bank, 1997) 5.

⁵² Ibid; Garnaut; Song and Yao, above n 21, 40

⁵³ China had 1,118 automotive enterprises in 1994. The total assets (the bulk of which were state-owned) and sales volume of these enterprises, however, amounted to only 5.89 per cent and 7.26 per cent of General Motor, and 5.26 per cent and 8.94 per cent of Ford. See 张翼湘 [JiXiang Zhang], 《国有控股公司理论与实践》 [Theory and Practice on State Holding Companies] (经济科学出版社 [Economic Science Press], 1999) 80.

⁵⁴ 江泽民 [Jiang Zemin], 《在党的十四届五中全会上的讲话》 [Speech at the Fifth Plenum of the Fourteenth Party Central Committee] (16 October 1995).

⁵⁵ Ibid.

⁵⁶ 《中华人民共和国国民经济和社会发展'九五'计划和2010年远景目标纲要》 [Outline of the Ninth Five-Year Plan on National Economic and Social Development and Strategic Vision and Main Targets for 2010], Adopted at the Fourth Plenum of the Eighth National People's Congress, 17 March 1996.

⁵⁷ Ibid.

consolidating the state sector, the formation of large state-owned corporate groups served a number of auxiliary purposes, such as maintaining employment levels by allowing larger and better performing SOEs to absorb other smaller and poor-performing ones.⁵⁸ However, the project took on a new urgency towards the end of the 1990s, due in part to China's much-anticipated WTO accession that eventuated in late 2001. Accordingly, the goal of establishing 'a team of internationally competitive large corporate groups' was incorporated into the PRC 10th Five-Year Plan (2001-2005).⁵⁹ In this regard, the impressive role played by the Japanese and South Korea large corporate groups, during their post-war high economic growth period, had greatly inspired Chinese policy makers.⁶⁰

Consistent with the state-led approach to corporatisation, top-down transplants were also utilised in fostering large enterprise groups. The various paths to group formation fell under two broad categories. The first was government-arranged mergers of loss-making SOEs with larger or better performing ones. At the national level, previously in 1991, the central government launched a project to form around 100 large enterprise groups, and 57 large SOEs were selected for the trial.⁶¹ The number was increased to 120 in 1997.⁶² In addition to the 'national team', every province also organised its own 'provincial team'.⁶³

The second category involved the conversion of government departments and industrial bureaus into state holding companies. Under the planned system, China had about 30 line ministries in charge of different industries, such as petro-chemical, textile and

⁵⁸ Lisa Keister, 'Engineering Growth: Business Group Structure and Firm Performance in China's Transitional Economy' (1998) 104 *American Journal of Sociology* 404, 404.

⁵⁹ 《国民经济和社会发展第十个五年计划纲要》 [Outline of the Tenth Five-year Plan on National Economic and Social Development], adopted at the Fourth Plenum of the Ninth National People's Congress, 15 March 2001.

⁶⁰ Peter Nolan, *China and the Global Economy: National Champions, Industrial Policy, and the Big Business Revolution* (Palgrave Macmillan, 2001) 15.

⁶¹ 《国务院批转国家计委、国家体改委、国务院生产办公室关于选择一批大型企业集团进行试点请示的通知》 [Circular of the State Council on Endorsing the Request of the State Planning Commission, System Reform Commission and the State Council Production Administration Office to Select the First Batch of Enterprises to Experiment the Large Enterprise Group System] (People's Republic of China) State Council, 14 December 1991.

⁶² 《关于深化大型企业集团试点工作的意见》 [Opinions on Deepening the Experiment with Large Enterprises Groups] (People's Republic of China) State Planning Commission, the State Economic and Trade Commission and the State System Reform Commission, 8 April 1997.

⁶³ Peter Nolan, 'Evaluation of the World Bank's Contribution to Chinese Enterprise Reform', (The World Bank, 1 January 2005) [http://lnweb18.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/C115BD744564229F85256FF000590B8C/\\$file/china_cae_enterprise_reform.pdf](http://lnweb18.worldbank.org/oed/oeddoclib.nsf/DocUNIDViewForJavaSearch/C115BD744564229F85256FF000590B8C/$file/china_cae_enterprise_reform.pdf); Aimin Chen and Ping Li, 'The Formation, Restructuring, and Performance of Chinese Enterprise Groups: The Case of Liaoning Province' (2008) 41 *Chinese Economy* 72.

electric power. Through the process of corporatisation, most of the line ministries were converted into one or several state holding companies with their administrative functions transferred to an umbrella central government agency, namely the State Economic and Trade Commission, the predecessor of the State Economic Reform and Development Commission.⁶⁴ Many of China's largest corporate groups, such as China Petrochemical Corporation (SINOPEC), and China Nonferrous Metal Industrial Corporation (the predecessor of the Aluminium Corporation of China) were formed in this way.⁶⁵ Similar arrangements also took place in various municipalities with respect to their local line bureaus.⁶⁶

Similar to the corporatisation process, the project of building large corporate groups was assisted with a broad array of policy supports. These included state-bank loans, tax deals, cheap land, privileged listing on international and domestic markets, and government procurement policy.⁶⁷

The second reform stage set SOEs on the path of growing into globally competitive large businesses, which has since remained one of the government's key objectives. However, by the end of the 1990s, many SOEs remained financially unviable. Among the 16,874 large and medium-sized SOEs in 1997, approximately 40 per cent (or 6,599) ran at loss.⁶⁸ Furthermore, as a side effect of the reform that substituted budgetary grants with bank loans, the average debt-to-equity ratio of SOEs dramatically increased from over 30 per cent at the start of the reform, to more than 65 per cent in 1998.⁶⁹ Many SOEs were operating at below half capacity due to serious financial difficulty.⁷⁰

Many factors may have contributed to the continuing inefficiencies of SOEs. These included the influence of the traditional system of SOEs under the 40-year planned

⁶⁴ 张承耀 [Zhang Chengyao], 《鲤鱼跃龙门: 中国企业改革备忘录》 [The Carp Jumping over the Dragon's Gate: A Memorandum of Chinese Enterprise Reform] (经济科学出版社 [Economic Science Publishing House], 1999) 45-47; Barry Naughton, 'The State Asset Commission: A Powerful New Government Body' (2003) 8 *China Leadership Monitor* 1, 4 <<http://www.hoover.org/publications/china-leadership-monitor/article/7836>>.

⁶⁵ 张承耀 [Zhang Chengyao], above n 64, 45-7.

⁶⁶ 刘小玄 [Liu Xiaoxuan], 《中国企业发展报告 (1999-2000)》 [Report of the Chinese Enterprise Development 1999-2000] (社会科学文献出版社 [Social Sciences Academic Press], 2000) 83.

⁶⁷ For a discussion on the various industrial policy supports, see Nolan, 'Evaluation of the World Bank's Contribution to Chinese Enterprise Reform' above n 63.

⁶⁸ 中央财经领导小组办公室 [Office of the Communist Party Central Finance and Economic Committee], above n 7, 60.

⁶⁹ Ibid 43.

⁷⁰ Ibid 42.

economy, and the poor adaptation of SOEs to the market that had emerged with the overall economic reform.⁷¹ An overemphasis of the corporate form over corporate governance has, however, been identified by commentators, such as Wu Jinglian, as an important factor.⁷² According to Hu Angang and Hu Guangyu, the key problem with these newly corporatised SOEs was insider control by managers. This was reflected in the widespread comingling of the board of directors with senior management, and that the board of supervisors⁷³ was set up merely as a formality. This problem further led to serious corruption and rampant depletion of state assets.⁷⁴

Against this background, at the First Plenum of the 15th Central Committee of the Party in September 1997, the Party launched an ambitious plan to turn the majority of large and medium-sized SOEs from loss-making to profit-making ones within three years, and to establish the modern enterprise system among the majority of these 'key SOEs' during the same time frame (the '1997 Plan').⁷⁵ Some drastic means were undertaken to achieve these goals. These included liquidation of many insolvent enterprises and a massive lay off of workers.⁷⁶

4.2.3 The 1999 Party decision and the formal adoption of the concept of corporate governance

Against this backdrop, the term 'corporate governance' was formally introduced by the Party in its 1999 *Decision on Several Important Issues on the Reform and Development of State-owned Enterprises* adopted at the fourth Plenum of the 15th Party Central Committee (the *1999 Decision*).

The promulgation of the *1999 Decision* was, in itself, a significant milestone in the history of Chinese SOE reform. The *Decision* reiterated the 1997 Plan, and set out the goals for the SOE reform in the next 10 years and the relevant guidelines and strategies. The *Decision* made it clear that the state sector would continue to play a leading role in

⁷¹ Ibid 2.

⁷² Wu Jinglian, above n 4, 155.

⁷³ The 1993 PRC *Company Law* required all joint stock companies to establish a general meeting, a board of directors and a board of supervisors. 1993 PRC *Company Law* arts 102, 112, 124.

⁷⁴ 胡鞍钢, 胡光宇 [Hu Angang and Hu Guangyu], '转轨时期中国公司治理的回顾和展望' [An Overview of Chinese Corporate Governance in Transition], in Hu Angang and Hu Gangyu (eds) 《公司治理中外比较》 [A Comparative Study on Chinese and Foreign Corporate Governance] (新华出版社 [Xinhua Publishing House], 2003) 1, 29.

⁷⁵ 江泽民 [Jiang Zemin], 《在中国共产党第十五次全国代表大会上的报告》 [Report at the 15th Congress of the Chinese Communist Party] above n 33.

⁷⁶ *1999 Decision*, above n 1.

the national economy. And for the first time, it identified several strategic sectors and industries that should continue to be controlled by the state.⁷⁷ In response to the widespread practice of corporatisation only 'in form', the 1999 *Decision* stressed that, except for a small number of SOEs that should remain wholly-owned by the state for strategic reasons, the rest of the large and medium-sized SOEs should be transformed into multiple-shareholder joint stock companies. The *Decision* also reiterated the Party's intention to foster a group of internationally competitive large businesses in the state sector.

The 1999 *Decision* stressed that the corporate system was an effective means to organise the 'modern enterprise system', and went on to state:

Corporate governance (*Faren Zhili Jiegou*) is the core of the corporate system. The responsibilities of the general meeting, the board of directors and the board of supervisors should be clarified, and a system of corporate governance with synchronised operations and checks and balances among all responsible corporate organs should be established.⁷⁸

Hence, the Party laid central importance on corporate governance. This marked a significant shift in the Chinese official thinking about the means to improve the management, and therefore efficiency, of SOEs. The over-simplified emphasis of separation of state ownership and control of SOEs as one of the predominant philosophies underpinning previous reform measures had been replaced by a focus on corporate governance to keep the managers accountable to those from whom they derive authority.

4.3 The actual concept of corporate governance adopted

Studies on corporate governance in listed SOEs in China had preceded the Party's formal adoption of the concept in 1999. For example, Wu Jinglian promoted the adoption of the Anglo-American concept of corporate governance into China as early as August 1993.⁷⁹ Wu defined corporate governance as:

[t]he organisational structure consisting of owner, board of directors and senior managers. A check and balance relationship is formed within that structure, through which the owner entrusts its capital to the board of directors. The board of directors is

⁷⁷ Ibid.

⁷⁸ Ibid.

⁷⁹ 吴晓波 [Xiaobo Wu], above n 29, 76-77.

the highest level of decision-making of the company and has the power to appoint, reward, penalise, or dismiss senior managers.⁸⁰

Several other definitions of corporate governance have been offered by various Chinese scholars along similar lines.⁸¹

At first glance, the concept of corporate governance adopted in the *1999 Decision* is not significantly different from Wu's definition. An examination of the governance structure recommended in the *1999 Decision*, however, suggests that the concept introduced by the Party was mainly concerned with solving the agency problem between the state and managers. The importance of corporate governance as a means to protect the interests of minority shareholders, central to the Anglo-American notion of corporate governance, was largely ignored.

The *1999 Decision* urged corporatised SOEs to set up an effective structure of corporate governance. In doing so, it specified the proper roles for various corporate organs, such as the general meeting, the board of directors and the board of supervisors, along the lines of the 1993 *Company Law*. The importance of establishing the related systems of monitoring and incentives, such as performance evaluation of the managers, was also mentioned. However, there was more. The *Decision* required such bodies as the Party Committee (the enterprise-based grassroots-level Party organisation), the trade union, and the employee representative congress to 'perform their roles and responsibilities according to the relevant law'. All these latter three bodies are, however, affiliated to the Party. For example, a reference to the *Trade Union Law* would reveal that all Chinese trade union organisations come under the All-China Federation of Trade Unions (ACFTU), the only legal trade union body in China, and subject to the leadership of the Party.⁸² The trade union organisation is the working body of the employee representative congress in a SOE.⁸³

Furthermore, the *1999 Decision* went beyond the company law stipulations by proposing to strengthen the role of the Party in wholly-stated owned and state-controlled companies. This was to be implemented through a system which has since

⁸⁰ Wu Jinglian, 'The Focus of the Reform in 1995' (in Chinese), mimeograph, cited in On Kit Tam, *The Development of Corporate Governance in China* (Edward Elgar, 1999) 19.

⁸¹ Tam, above n 80.

⁸² 《中华人民共和国工会法》 [Trade Union Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October, 2001 (first introduced on 3 April 1992) arts 4, 10, 11.

⁸³ Ibid art 35(2).

been referred to as 'bilateral entry and cross appointments'.⁸⁴ The system encourages members of the Party Committee to be appointed as company directors or supervisors. It also encourages that the positions of the Party Secretary, as the leader of the company-based Party Committee, and the chairperson of the board of directors, be assumed by one person.⁸⁵

Nevertheless, by contrast with the strong emphasis on improving the management of the incorporated SOEs, the issue of investor protection, a central focus of the Anglo-American outsider-based model of corporate governance, was not particularly emphasised in the *1999 Decision*. The document briefly stated that 'the board of directors should maintain the interests of investors and be responsible to the general meeting'.⁸⁶ There was, however, no mention of minority shareholder protection. This was despite the fact that, as discussed in Chapter 2, the need for investor protection is typically greater in companies with concentrated share ownership.

4.4 Conclusion

The chapter has traced the Chinese two-stage SOE reform that led to the official adoption of the concept of corporate governance in China, particularly through the Party's 1999 *Decision on Several Important Issues on the Reform and Development of State-owned Enterprises*. In doing so, this chapter has shown that instead of shareholder-oriented objectives, the concept was adopted by the Chinese Party-state to raise the efficiency of SOEs through improving their management. As such, Chinese policy makers did not embrace the full version of the Anglo-American concept of corporate governance.

This chapter has shown that the concept embraced by the Party was two-fold. First, consistent with the Chinese form of state capitalism, it was not aimed at removing state control of corporatised SOEs, particularly the large SOEs considered to be strategic by the state. Second, the concept was mainly concerned with improving the management of the large corporatised SOEs through solving the agency problem between the state, as the controlling shareholder, and managers. In contrast, the broader agency problems

⁸⁴ 《关于加强和改进中央企业党建工作的意见》[Opinion on Strengthening and Improving Party Building Work in Central Government-affiliated SOEs] (People's Republic of China)The Organisational Department of the Central Party Committee and the Party Committee of the State-owned Assets Supervision and Administration Commission, 31 October 2004.

⁸⁵ *1999 Decision*, above n 1.

⁸⁶ *Ibid.*

between managers and shareholders as a whole, and between the controlling and minority shareholders, which are central to the Anglo-American concept of corporate governance (as discussed in Chapter 2), was not considered an important concern. As Chapter 5 will demonstrate, this two-fold notion underpinned the law and practice in relation to corporate governance in Chinese listed SOEs prior to the 2005 corporate law reforms.

As will be illustrated in Chapters 6 and 7, this concept of corporate governance has evolved over the past few years, and become expressive of forces such as economic globalisation and the pluralisation of interests within Chinese domestic society. The adoption of more investor and stakeholder-friendly rules and principles has led to a much broader notion of corporate governance in China.

However, in terms of the relevant importance of the state, public investors and other stakeholders within listed SOEs, as the ensuing chapters will demonstrate, the fundamental role of corporate governance in promoting policy goals has largely remained unchanged, and therefore, remains the key factor in aligning Chinese corporate governance to a state-centric approach.

CHAPTER 5 MAIN FEATURES OF AND PROBLEMS WITH CORPORATE GOVERNANCE IN LISTED SOES PRIOR TO THE 2005 CORPORATE LAW REFORMS

5.1 Introduction

Having considered the official adoption of the concept of corporate governance in China during the course of the state-owned enterprise (SOE) reform, this chapter addresses the second set of subsidiary research questions by examining the law and practice concerning the governance of listed SOEs in the lead up to the 2005 corporate law reforms. In doing so, this chapter serves the main purpose of this research from two perspectives. First, it tests the applicability of the post-war former state-led model of corporate governance to Chinese listed SOEs during this period. Second, it helps to elucidate the rationale behind China's post-2005 legal and regulatory reforms concerning the governance of these companies. These reforms will be examined in the ensuing four chapters.

This chapter is divided into five sections. To set the background, section 5.2 provides a brief overview of the regulatory environment for corporate governance in China prior to 2005 and the key regulatory and market actors involved in that environment. As will be shown in the next two chapters, these actors have largely remained unchanged post the corporate law reforms. Sections 5.3 to 5.5 examine China's pre-2005 law and practice concerning the three sets of company relations central to the former state-led model, namely, state-manager relations, investor protection and non-shareholder stakeholder (including employee) protection, within large listed SOEs. The three sections will each focus on one set of these relations, and in that order. In each section, the main features of the relevant legal and regulatory framework will be examined. This is followed by empirical evidence on how the framework played out in reality. The empirical evidence will be drawn from original data collected from 2002 to 2004 through an Australian Research Council (ARC)-funded project on the governance of China's top 100 listed companies (ARC project). The details of the ARC project, including the role of this author in it, were explained in Chapter 1. As also noted in that chapter, the overwhelming majority of these companies were (and remain) controlled by the state. The various problems underlying the law and practice concerning each of the relevant sets of company relations will also be identified and discussed in sections 5.3 to 5.5.

Section 5.6 summarises the main findings and their implications for understanding China's post-2005 corporate governance reforms.

This chapter will show that the governance of state-controlled listed companies in China prior to the 2005 reforms resembled some key features of the former state-led model. Yet, the Chinese model had some characteristics of its own. Similar to the former state-led model, state-manager relations in listed SOEs were characterised by strong state involvement in management decision-making. However, extensive management powers vested in the general meeting and the Chairman of the board of directors, coupled with lax internal and external monitoring of the exercise of those powers, led to a dual governance problem in these companies. Strong state intervention in corporate affairs paradoxically co-existed with insider control by senior corporate executives and parent SOEs. This dual problem appeared to have undermined not only managerial efficiency, but also the effectiveness of state control over these large companies.

In relation to the protection of investors and other stakeholders including employees, similar to the former state-led model, China's pre-2005 corporate governance was characterised by the muted voice of outsider investors and poor protection of non-shareholder stakeholders, except employees. Nevertheless, compared to the former state-led model, exploitation of minority shareholders by parent SOEs appeared to be far more common and serious in Chinese companies. This was, in part, contributed by the lack of provision for shareholder rights and remedies in the corporate law, and in part, the overlapping roles of the state as the controlling shareholder, a stock market regulator and adjudicator of securities-related disputes.

As will be discussed in Chapter 8, China's fostering of internationally competitive large enterprises took place in far more dynamic and complex international and domestic environments, compared to the former post-war state-led economies. Economic globalisation and the pluralisation of interests within domestic society increased pressure on the state to improve the governance of listed SOEs. As such, many legal and regulatory reforms post-2005 can be better understood as tools to solve various governance problems with these companies, including the problems highlighted in this chapter, rather than a pure indication of China's greater embrace of any of the prevailing international corporate governance models including the Anglo-American model.

5.2 Pre-2005 regulatory environment

The regulatory environment for corporate governance in China prior to the 2005 corporate law reforms was centred on the state. Most of the key regulatory actors involved in this environment were either state-based or otherwise linked with the government. As Clarke noted:

The Chinese state prefers direct regulation by government agencies first, and indirect regulation by private litigation in the state's courts next. Regulation by the uncontrolled institutions of the market comes a distant third, and indeed it is hard to find such institutions in China.¹

As will be discussed next, the initial framework for regulating corporate governance was established through the 1993 *Company Law*² and the 1998 *Securities Law*.³ This was despite the fact that the concept of corporate governance was not officially introduced into China until the late 1990s (as explained in Chapter 4).

As the importance of corporate governance took the central stage in China from the early 2000s, the China Securities Regulatory Commission (CSRC) was entrusted with the responsibility to improve corporate governance in listed companies. As a ministry-level agency affiliated to the State Council, the CSRC is the central government regulator of the stock market and listed companies in China. As section 5.3 will further illustrate, two documents issued by the CSRC have remained highly important to modernising the Chinese system of corporate governance. These are the *Code of Corporate Governance for Listed Companies*⁴ and the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*.⁵ Other rules and guidelines issued by the CSRC covered a broad range of topics, including the form and content of company constitution,⁶ procedures for conducting shareholders' meetings,⁷

¹ Donald Clarke, 'The Ecology of Corporate Governance in China,' (George Washington University Law School Legal Studies Research Paper No. 433; GWU Law School Public Law Research Paper No. 433, 29 August 2008) 57 <<http://ssrn.com/abstract=1245803>>.

² 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993 ('1993 PRC Company Law').

³ 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1998 ('1998 PRC Securities Law').

⁴ 《中国上市公司治理原则》 [Code of Corporate Governance for Listed Companies in China] (People's Republic of China) China Securities Regulatory Commission and State Economic and Trade Commission, 7 January 2002 ('CSRC Code of Corporate Governance').

⁵ 《关于在上市公司建立独立董事制度的指导意见》 [Guidelines for the Introduction of Independent Directors into Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 16 August, 2001 ('Guidelines for Introduction of Independent Directors').

⁶ 《上市公司章程指引》 [Guidelines on Article of Association of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 16 December 1997.

specific rules on strengthening the protection of public investors,⁸ and information disclosure.⁹

In addition to the CSRC, the State-owned Assets Supervision and Administration Commission (SASAC) was a key central government regulator of listed SOEs. As noted in Chapter 2, the creation of SASAC has been regarded by commentators, such as Naughton, as a critical juncture in the development of state capitalism in China.¹⁰ As the central state assets management authority affiliated to the State Council, SASAC was also entrusted with the responsibility to strengthen corporate governance in SOEs including listed SOEs.¹¹ As the role of SASAC in this area has become particularly evident since mid-2004,¹² the various SASAC-led reforms will be considered in Chapters 6 and 7, alongside other post-2005 legal and regulatory reforms of corporate governance in listed SOEs.

Pertinent to the governance of listed SOEs, another two regulatory bodies were the Shanghai and Shenzhen Stock Exchanges. The two exchanges were officially defined as 'not-for-profit legal persons' under the 1998 *Securities Law*.¹³ However, as noted in Chapter 4, they have operated as the *de facto* subdivisions of the CSRC since 1998, when the CSRC took over control of the two exchanges from their respective municipal governments.¹⁴ The listing rules of the stock exchanges set out, among other things,

⁷ 《上市公司股东大会规范意见》 [Opinions on Standardising the General Meeting of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 15 May 2000.

⁸ 《关于加强社会公众股东权益保护的若干规定》 [Several Provisions on Strengthening the Protection of the Rights and Interests of Public Shareholders] (People's Republic of China) China Securities Regulatory Commission, 7 December, 2004.

⁹ Prior to the 2005 *Company Law* reform, the CSRC had issued 22 sets of Rules concerning the content and format of disclosure by companies issuing securities to the public. 《公开发行证券的公司信息披露内容与格式准则第1-22号》 [Rules No.1-22 on the Format and Contents of Information Disclosure by Companies Issuing Securities to the Public] (People's Republic of China) China Securities Regulatory Commission; 《证监会关于进一步加强ST、PT公司信息披露监管工作的通知》 [Circular of the CSRC on Strengthening Supervision of Disclosure by ST and PT Companies] (People's Republic of China) China Securities Regulatory Commission, 7 June 2000.

¹⁰ Barry Naughton, 'The Transformation of the State Sector: SASAC, the Market Economy and the New National Champions' in Barry Naughton and Kellee Tsai (eds) *China's State Capitalism: Growth and Crisis 2* <<http://www.cccr.ust.hk/cgi-bin/cccr.php/event/detail/33>> (Cambridge University Press, forthcoming).

¹¹ 《企业国有资产监督管理暂行条例》 [Interim Regulations on the Supervision and Administration of Enterprise State-owned Assets] (People's Republic of China) State Council, 13 May 2003, Art 13.

¹² As discussed in Chapter 6, this was when SASAC introduced the standardised board reform into parent SOEs of listed companies.

¹³ 1998 *PRC Securities Law* art 109 (1).

¹⁴ During the ARC project interviews, this view was expressed by a former Chairman of the CSRC who saw the stock exchange Listing Rules as 'part of the overall regulations of the CSRC' (Interview code BJ00530).

disclosure responsibilities for listed companies and their officers, such as directors, supervisors, senior managers and the board secretary.¹⁵

The Supreme People's Court (SPC) also played an indirect role in the regulation of corporate governance in China. The SPC has issued several opinions concerning the application of various provisions of the *Company law* and *Securities Law* by local courts.¹⁶ As China has followed the continental law tradition, judicial opinions are not a primary source of law. However, judicial opinions issued by the SPC are generally perceived as either 'binding upon the courts' or 'highly persuasive and likely to be followed by the courts'.¹⁷

Chinese courts have been widely perceived as lacking independence from local governments.¹⁸ Ginsburg attributed this to 'the fact that that judges are dependent on local governments for appointment, promotion and until recently, funding and material security'.¹⁹ Another factor is the existence of a political and legal affairs committee under the Chinese Communist Party (the Party) Committee at each government levels. One of the main roles of the political and legal affairs committees is to oversee the work of local law enforcement agencies, including the courts.²⁰

Despite being less visible in the corporate law, the Party was, and remains, a prominent actor in corporate governance in China. As will be demonstrated throughout this thesis,

¹⁵ 《上海证券交易所股票上市规则》[Shanghai Stock Exchange Listing Rules] (People's Republic of China) Shanghai Stock Exchange, first became effective in January 1998, has since undergone several revisions with the most recent taking place on 7 July 2012; 《深圳证券交易所股票上市规则》[Shenzhen Stock Exchange Listing Rules], first became effective in January 1998, has since undergone several revisions with the latest taking place on 7 July 2012.

¹⁶ 《最高人民法院关于涉证券民事赔偿案件暂不予受理的通知》[Circular on Temporary Non-acceptance of Securities-related Civil Compensation Cases] (People's Republic of China) Supreme People's Court, 21 September 2001; 《最高人民法院《关于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》》[The Notice on Relevant Issues Concerning Accepting Tort Cases Caused by False Statement on the Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002; 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》[Several Provisions on Trial of Civil Compensation Cases Arising from Misrepresentation on the Securities Market] (People's Republic of China) Supreme People's Court, 9 January 2003.

¹⁷ Jiangyu Wang, 'Legal Reform in an Emerging Socialist Market Economy' in Ann Black and Gary Bell (eds) *Law And Legal Institutions of Asia: Traditions, Adaptations And Innovations* (Cambridge University Press, 2011) 24, 37.

¹⁸ Tom Ginsburg, 'Judicial Independence in East Asia: Lessons for China' in Randall Peerenboom (ed), *Judicial Independence in China: Lessons for Global Rule of Law Promotion* (Cambridge University Press, 2009) 247, 257; Randall Peerenboom, 'Introduction' in Randall Peerenboom (ed), *Judicial Independence in China: Lessons for Global Rule of Law Promotion* (Cambridge University Press, 2009) 1, 13-16; Liebman Benjamin, 'China's Courts: Restricted Reform' in Donald Clarke (ed) *China's Legal System: New Developments, New Challenges* (Cambridge University Press, 2008) 66, 66.

¹⁹ Ginsburg, above n 18.

²⁰ Political and Legal Affairs Committee of the Central Party Committee website <<http://www.chinapeace.org.cn/>>.

the Party has not only been the chief supplier of major reform policies, but also been deeply involved in the governance of individual companies through, among other means, the Party's 'cadre management system'.²¹ The system allows the Party, through the Organisational Department of the Central Party Committee and its local branches, to exercise ultimate control over the appointment and evaluation of personnel in leadership positions in government organisations, including SOEs.²²

State-controlled listed companies were (and are) no exception. This was despite the 1993 *Company Law*'s provision for the appointment of top corporate positions. The *Company Law* provided that the Chairman of the board of directors in a joint stock company should be elected by the board of directors from directors,²³ and the General Manager be appointed by the board.²⁴ In reality, before SASAC was established in 2003, the top three positions in central government-affiliated SOEs (central SOEs), namely, the Party Secretary, the Chairman and the General Manager, were appointed and evaluated by the Organisational Department of the Central Party Committee. As discussed in Chapter 6, this situation has not dramatically changed since the creation of SASAC. In addition to the appointment of key leadership positions, the role of the Party was, and remains, embedded in listed SOEs through company-based Party committees and other Party-sponsored organisations, such as the trade union and the women's federation.²⁵

At the corporate level, parent SOEs, usually wholly-owned by a central or local government agency, were key actors in the governance of listed SOEs. As discussed in Chapter 4, the prevalence of parent SOEs among listed companies was associated with corporatisation and partial listing of SOEs from the early 1990s. As the review of state-manager relations in China's top 100 listed companies below will demonstrate, most parent SOEs had strong influence over the governance of their listed subsidiaries through multiple avenues.

²¹ Barry Naughton, 'China's Distinctive System: Can it be a Model for Others?' (2010) 19 *Journal of Contemporary China* 437, 456-7.

²² For a detailed illustration of the system, see John Burns (ed), *The Chinese Communist Party's Nomenklatura System* (M.E. Sharp, 1989).

²³ 1993 *PRC Company Law* art 113(1).

²⁴ *Ibid* art 119(1).

²⁵ All grassroots including enterprise-based women's federation organisations come under the All China Women's Federation, which is a government agency. 《中华人民共和国妇女权益保障法》 [Law of the People's Republic of China on the Protection of Rights and Interests of Women] (People's Republic of China) National People's Congress Standing Committee, 28 August 2005, art 6.

Public investors of listed companies, including listed SOEs in China, were mainly made up by small individual investors. This is in contrast to the Anglo-American countries where large financial institutions, including pension and superannuation funds, dominate the investor base. There were over 70 million accounts held by public investors on the Chinese stock market in 2006. Most of these accounts holders were individual investors.²⁶

The relatively low percentage of institutional investment was, in part, due to the short history of the Chinese stock market, and partly, the predominance of state ownership in listed companies in China. In view of the important role played by financial institutions in the development of stock market and corporate governance in Western developed market economies, China has encouraged institutional investment since the early 2000s. The promulgation of the *Securities Investment Funds Law* in 2003 generated an explosive growth of the investment funds industry.²⁷ National Social Security funds, insurance companies and securities companies were also allowed to hold shares in listed companies, although under prescribed investment ceilings.²⁸ In addition, since 2002, Qualified Foreign Financial Institutions (QFII) have been allocated quotas by the State Administration of Foreign Exchange (SAFE) to trade shares on the Chinese stock market. However, by October 2006, shares held by institutional investors accounted for only 30 per cent of the total tradeable shares, or around 10% of total shares issued by Chinese listed companies.²⁹ Therefore, the protection of public investors, particularly individual investors was, and remains, one of the most crucial issues in corporate governance in China.

The above analysis shows that similar to the Chinese state-led approach to economic development, a large and visible role of the state was present in China's pre-2005 regulatory environment for corporate governance. However, as the examination of the

²⁶ Qiao Liu, 'Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants' (2006) 52 *CESifo Economic Studies* 415, 421.

²⁷ 《中华人民共和国证券投资基金法》 [Securities Investment Fund Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 28 October 2003; Chao Xi, 'Institutional Shareholder Activism in China: Law and Practice (Part 1)' (2006) 17 *International Company and Commercial Law Review* 251, 252.

²⁸ Zhong Zhang, 'Legal Deterrence: the Foundation of Corporate Governance-Evidence from China' (2007) 15 *Corporate Governance: An International Review* 741, 744.

²⁹ Lu Ding and Li Ning, 'China's Market Reform: Problems and prospects' in John Wong and Wei Liu (eds), *China's Surging Economy: Adjusting for More Balanced Development* (World Scientific, 2007) 253, 264, 284; 中国证券监督管理委员会 [China Securities Regulatory Commission], 2007 年年报 [2007 Annual Report] <http://www.csrc.gov.cn/pub/newsite/zjhjs/zjhnb/200904/t20090423_102465.htm>. As the 2005 'split share structure reform' was carried out in stages, most non-tradeable state and state legal person shares did not become tradeable until 2007.

Chinese pre-2005 law and practice in relation to three sets of company relations within listed SOEs below will suggest, various problems existed in the governance of these companies, which appeared to have jeopardised not only their long-term development, but also the effectiveness of state control over these companies.

5.3 State-manager relations

Corporate governance in China has been described as 'a control-based model, in which the controlling shareholders - in most case, the state - employ all feasible governance mechanisms to tightly control the listed firms'.³⁰ While the regulatory environment reviewed above lends support to this characterisation, it may have exaggerated the degree of effective control exerted by the state over corporate managers. As the review of the Chinese pre-2005 law and practice concerning state-manager relations in listed SOEs below will suggest, despite strong state intervention in corporate affairs, insider control of listed SOEs by their top executives and parent SOEs was prevalent.

5.3.1 The legal and regulatory framework

The governance structure introduced by the 1993 *Company Law* was very hierarchical. The structure consisted of a general meeting, defined as the company's 'organ of authority',³¹ and two parallel boards mainly elected by the general meeting. These were the board of directors, as the company's 'executive organ',³² and the board of supervisors as the 'watchdog'.³³

With the 1993 *Company Law*'s adherence to the 19th century principle of general meeting supremacy,³⁴ the first avenue for the state to intervene in the affairs of listed SOEs was the general meeting. In Anglo-American outsider-based corporate governance, the powers of the company, including managerial powers, are generally vested in the board of directors.³⁵ By contrast, the 1993 *Company Law* conferred a long list of management powers on the general meeting of joint stock companies, including

³⁰ Qiao Liu, above n 26, 418.

³¹ 1993 *PRC Company Law* art 102.

³² *Ibid* art 112.

³³ Xianchu Zhang, 'Company Law Reform in China' in John Garrick (ed), *Law and Policy for China's Market Socialism* (Routledge, 2012) 39, 40; 1993 *PRC Company Law* arts 124, 126.

³⁴ John Farrar, *Corporate Governance: Theories, Principles and Practice*, (Oxford University Press, 2nd ed 2004) 69; Robert Art and Minkang Gu, 'China Incorporated: The First Corporation Law of the People's Republic of China' (1999) 20 *Yale Journal of International Law* 273, 297; Yongxin Song, 'Some Special Features of the Organs of Governance of Chinese Business Corporations' 1995 (24) *Capital University Law Review* 207, 214.

³⁵ See, for example, the Australian *Corporations Act 2001* (Cth) s 198A.

listed SOEs. These included appointing and remuneration of directors and supervisors, making decisions on company's operational guidelines and long term capital investment plans, approving annual budget plans and final accounts, and approving corporate fundraising through issuing shares and debentures.³⁶

Extensive powers vested in the general meeting inevitably limited the role of the board of directors. Unlike its counterparts in Anglo-American jurisdictions, the role of the board under the 1993 *Company Law* was 'implemental' in nature.³⁷ In addition to carrying out resolutions of the general meeting, the board was responsible for the formulation of various guidelines, plans and reports to be deliberated at the general meeting. The limited decision-making powers of the board were mainly concerned with the establishment of company day-to-day management structures and systems.³⁸

Even more marginalised by the supremacy of the general meeting was the board of supervisors. This board was made up by shareholder and employee representatives,³⁹ and carried out their monitoring role mainly through attending meetings of the board of directors as non-voting participants and inspecting company accounts.⁴⁰ The supervisory board has been generally regarded as a transplant from the German two-tiered board system.⁴¹ However, unlike its German counterpart, the Chinese supervisory board was given few powers in relation to either information gathering or handling of managerial misconduct,⁴² let alone the power to appoint or remove directors. Explaining the 'lost powers' of the Chinese supervisory board, Clarke argued that while this board was expected to provide some oversight function, they were not intended to become an 'extra layer of supervision and bureaucracy between the governmental department in

³⁶ 1993 PRC *Company Law* art 103.

³⁷ 江平, 李国光 [Jiang Ping and Li Guoguang] (eds), 《最新公司法条文释义》 [*Annotated New Company Law*] (人民法院出版社 [The People's Court Publishing House], 2005) 304

³⁸ 1993 PRC *Company Law* art 112.

³⁹ *Ibid* art 124. The supervisory board consisted members elected by shareholders and employees. As discussed in Chapter 7, the minimum percentage of employee representatives was further specified in the 2005 amendment to the 1993 *Company Law*.

⁴⁰ 1993 PRC *Company Law* art 126.

⁴¹ Donald Clarke, 'Lost in Translation? Corporate Legal Transplants in China' (GWU Law School Public Law Research Paper No. 213; GWU Legal Studies Research Paper No. 213, July 3, 2006) 5 <<http://ssrn.com/abstract=913784>>; Chao Xi, *Corporate Governance and Legal Reform in China* (Wildy, Simmonds & Hill Publishing, 2009) 185.

⁴² Xi, above n 41, 160.

charge of the enterprise and its management', thereby hindering government involvement in corporate affairs.⁴³

Another, and perhaps more important, avenue for the state to influence corporate governance in listed SOEs was the latter's senior management, particularly the chair of the board of directors (commonly referred to in China as the 'Chairman'). As noted in section 5.2, this position in joint stock companies, including listed SOEs, was created by corporate law. However, it was often appointed by the Party through its organisational departments.

In many respects, the Chairman's role under the 1993 *Company Law* was quite similar to a top manager in a traditional SOE. This is despite the *Company Law*'s provision for the General Manager, another senior management position charged with supervising the company's day-to-day operations.⁴⁴ The Chairman was given a broad range of powers and responsibilities. Hence, in addition to convening and presiding over shareholders and board meetings, the Chairman was responsible for examining the implementation of board resolutions.⁴⁵ This person was also the sole person to whom the board could delegate part of its functions outside board meetings.⁴⁶ Most importantly, as the statutory 'legal representative' of the company,⁴⁷ the Chairman had the sole power to represent the company in executing contracts and undertaking legal proceedings.⁴⁸ As the discussion of the empirical evidence below will suggest, extensive powers and responsibilities associated with the Chairman role often led the person in that position to overstep the General Manager to become the company's real chief executive officer. As further discussed below, this was particularly the case, where the political leadership status of the Chairman was reinforced by their concurrent appointment to the company's Party Secretary's role.⁴⁹

⁴³ Donald Clarke, 'Lost in Translation?' above n 41, 8.

⁴⁴ 1993 *PRC Company Law* art 119.

⁴⁵ *Ibid* art 114.

⁴⁶ *Ibid* art 120 (1).

⁴⁷ *Ibid* art 113 (2).

⁴⁸ 《中华人民共和国民法通则》 [General Principles of Civil Law of the People's Republic of China] (People's Republic of China) National People's Congress, 12 April 1986, art 38.

⁴⁹ 《中共中央关于国有企业改革和发展若干重大问题的决定》 [Decision of the Central Committee of the Chinese Communist Party on Several Major Issues Concerning the Reform and Development of State-owned Enterprises], Adopted at the Fourth Plenum of the 15th Central Committee of the Chinese Communist Party, 22 September 1999.

As the CSRC took on the leading role of promoting good corporate governance in listed companies, it sought to introduce some checks and balances into this general meeting and Chairman-centred governance structure through borrowing from Anglo-American experiences. First, the CSRC issued the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*.⁵⁰ The *Guidelines* require all listed companies to have at least one-third independent directors, with at least one of them being an accounting professional. These directors are required to play an important role in monitoring the executive directors, and protecting the interests of the minority shareholders. Hence, they must provide independent opinions on certain issues of corporate governance in listed companies, such as the nomination, appointment and removal of directors and senior managers. They must also certify all major related party transactions before submission for board approval. To enable independent directors to fulfil these responsibilities, the *Guidelines* give them some special powers, such as the powers to call extraordinary shareholders' and directors' meetings, and to appoint outside auditors and consultants.

Another initiative introduced by the CSRC was the establishment of the Anglo-American style specialised board committees within Chinese listed companies. The *Code of Corporate Governance for Listed Companies* (The *Code of Corporate Governance*) issued by the CSRC in 2002 recommends the establishment of specialised board committees, including the audit committee, the nomination committee, and the remuneration and appraisal committee, in listed companies.⁵¹ As will be outlined in section 5.4, other provisions of the *Code* spell out principles on shareholders' rights, and lay down some behavioural rules for controlling shareholders.⁵² While designed to strengthen the protection of investors, these rules may impose additional constraints on the conduct of company directors and managers.

However, these reform measures introduced by the CSRC did not alter the basic governance structure established by the 1993 *Company Law*. As the review of the empirical evidence on state-manager relations in China's top 100 listed companies during 2002 to 2004 below will suggest, strong state involvement in listed companies

⁵⁰ *Guidelines for Introduction of Independent Directors*, above n 5.

⁵¹ *CSRC Code of Corporate Governance*, above n 4, art 52. For example, the main functions of the nomination committee include (1) formulating standards and procedures for the election of directors and make recommendations and (2) seeking and reviewing candidates for directorship and management positions and make recommendations. See *CSRC Code of Corporate Governance*, above n 4, art 55.

⁵² *Ibid*, chs 1, 2.

continued to be facilitated by extensive corporate powers vested in the general meeting, and the Chairman who owed their career prospects to the Party-government. Nevertheless, as the review of the empirical evidence will further suggest, the concentration of management powers in these corporate actors, coupled with poor internal and external monitoring of the exercise of those powers, paradoxically led to insider control of listed SOEs by their top executives and parent SOEs. This was despite strong state intervention.

5.3.2 Features of and problems with governance practices

From the ARC project interviews, strong state involvement in corporate affairs was a key feature of corporate governance in large listed SOEs during 2002 to 2004. When asked to comment on the impact of the state as a dominant shareholder on the governance practices of these companies, many interviewees pointed to government influence on management decision-making. As the board secretary of a Shanghai-based retail company stated:

In such companies, the State holds the majority shares and so decision-making in these companies involves state-owned assets. The company must talk to the government before it puts resolutions to the board or AGM (Annual General Meeting).⁵³

The Party/government was also perceived by some interviewees as the most important stakeholder in large state-controlled listed companies. For example, a former senior official of the CSRC remarked, when asked to identify the most important stakeholders in PRC listed companies, '[t]he Party, the government, their employees and their shareholders (in that order)'.⁵⁴ Similarly, a Shanghai-based corporate governance consultant stated, '[w]here there is a large majority shareholder, especially if it is the state, this ownership drives decision-making and the mentality of the management'.⁵⁵

In addition to controlling shareholding of the state, Party-government appointment of top corporate executives, including the Chairman, was seen by some interviewees as the primary source of state interference in corporate affairs.⁵⁶ As an in-house counsel of an insurance company put it:

⁵³ Interview code SH08217.

⁵⁴ Interview code HK05508.

⁵⁵ Interview code SH08020.

⁵⁶ For example, the company secretary of a Nanjing-based trading company stated, 'Under the Company Law, the Chairman and General Manager should be appointed by the Shareholder general meeting [The correct organ for electing the Board of Directors and the general meeting should be the Board of Directors rather than shareholders

Directors of listed companies will first check with controlling shareholders. This is the biggest problem for state-controlled listed companies. In most these companies, the Chairman and senior management are appointed by the government, so they are very careful about issues relating to the government or controlling shareholders ...⁵⁷

As government appointees, it was not unusual for senior executives of state-controlled companies to be transferred between large SOEs and government agencies. As a Beijing-based accountant remarked, '[i]t is common to see the Chairman going on to become a senior official'.⁵⁸

While the state and parent SOEs were often treated as one (and indeed, the reference to 'the state as a dominant shareholder' is misleading in itself), the overall impression from the ARC project interviews was that the involvement of parent SOEs in the affairs of listed companies was far stronger than direct government intervention. This can be traced back to the popular practice of 'partial listing' of SOEs as discussed Chapter 4. The parent-subsidiary relationship was described by a Hong Kong-based shareholder activist as inseparable:

I think the senior management and the controlling shareholder operate as one. They are usually located in the same premises. The listed company is seen as a way to attract funds for the group. The listed company should support the group. Decisions are made with the full knowledge of the majority shareholder.⁵⁹

From the ARC project interviews, parent SOEs typically controlled the appointment of all non-independent directors (including executive and non-executive directors), accounting for about two-thirds of directors in listed companies.⁶⁰ Parent SOEs also had strong influence over the appointment of independent directors and board of supervisors in their listed subsidiaries. The candidates for the independent directors were often put forward by parent SOEs (or in conjunction with the listed company's senior management), and the board of supervisors was typically made up of representatives of

general meeting—correction added by the author] In practice, for state-owned or controlled companies, they are appointed by the organisational Department of the municipal Party Committee.' (Interview code NJ09915)

⁵⁷ Interview code BJ06817.

⁵⁸ Interview code BJ06917.

⁵⁹ Interview Code HK10617.

⁶⁰ Most companies interviewed in the ARC project had 1/3 or a little over 1/3 independent directors to satisfy the minimum requirements provided in the *Guidelines for Introduction of Independent Directors* (See above n 5). For example, the board secretary of a Beijing-based company stated, when asked about the corporate governance role of independent directors, 'According to CSRC regulations, each listed company must have 1/3 independent directors on its board. Many listed companies have appointed 4 independent directors to meet this requirement. We have 4 independent directors among 12 directors. These 4 are appointed for the needs of our business. One is an IT expert, one is an expert in international law and one is a 'TFT' expert. They play an important role in the corporate governance of our company' (Interview code BJ01222).

parent SOEs, as well as members of the listed company's Party Committee and employee representatives.⁶¹ As discussed earlier, the appointment of top management positions in listed SOEs was controlled by the Party.⁶² However, it was not uncommon for the Party organisational departments to appoint candidates to those positions from the listed companies' state-owned parents.⁶³ Nor was it uncommon for senior executives to hold concurrent positions in listed companies and their state-owned parents.

This level of parent involvement in the personnel arrangements in listed SOEs had a direct influence on the patterns of business decision-making in these companies. For example, when asked to comment on the impact of the state, as a controlling shareholder, on the governance of listed companies, the board secretary of a logistics and transportation company in Shanghai stated:

... If the board wants to make a decision, it will first contact the parent company. It is normal in China, as the parent company has full control of the listed company ...⁶⁴

A similar observation was made by the company secretary of a Shanghai-based construction company:

There are certain rules, and the Chairman needs to know what kinds of matters need prior approval. Some matters just need a memorandum. In my view, parent companies have too much involvement in Chinese listed companies.

Only a few company insiders suggested that their Chairmen or boards of directors had autonomy in making business decisions.⁶⁵ For example, in a Qingdao-based company:

The Chairman and the General Manager want to make their own decisions. They want to gain some benefits from the parent company or the government, but are reluctant to

⁶¹ This was according to a Beijing-based law professor (Interview code BJ00306(c)). Some other interviewees observed that most supervisors were company employees or decided by majority shareholders.

⁶² The practice was also mentioned by some interviewees including the company secretary of the Nanjing-based trading company (Interview Code NJ09915). A Beijing-based law professor also stated, '[i]n big listed companies, the Chairman and General Manager are appointed by CCP organisational department' (Interview Code BJ01014).

⁶³ For example, the company secretary of a power company stated, '[i]t is difficult for us not to have a chairman with an executive job in the parent company. We look for other ways to improve corporate governance' (Interview Code BJ00706 (a)). The coincidence of senior executives in listed companies and their parent SOEs was quite common among large state-controlled listed companies in China. As will be explained in Chapter 9, the overlapping top executive roles in listed companies and their parent SOEs have largely remained unchanged after the 2005 company law reform.

⁶⁴ Interview code HK07947.

⁶⁵ For example, the company secretary of a Qingdao-based company stated: 'the Qingdao government is very open and never interferes in the governance of our company. The Chairman is appointed by the government' (Interview code QD02517).

inform them too much. In some extreme cases, the Chairman wants to become the boss of the company.⁶⁶

In addition to parent SOEs, the Chairmen played an important role in the governance of listed SOEs. This led some interviewees to use the term 'the key man' model to describe governance of large listed SOEs in China. This model was described by an official of the Shanghai Stock Exchange in the following way:

If a listed company has a dominant shareholder, that shareholder will control everything. So, one person, usually the Chairman, controls everything in the listed company. It is the 'key man' model, the traditional Chinese model.⁶⁷

Indeed, the Chairman was frequently mentioned by the interviewees as the top person-in-charge in a listed company. As an official from the CSRC put it, when asked to comment on the level of understanding of corporate governance principles held by the General Manager, 'in China, the Chairman is the No.1 person in a company, the real CEO. The General Manager is appointed by the Chairman and not like Western CEOs'.⁶⁸ The company secretary of a Nanjing-based iron and steel company also agreed:

In Chinese companies, usually when the Chairman has signed his name on a document, the other directors will follow him and sign. They will never do so if the chairman has not signed. Therefore, it is the Chairman who makes the decision.⁶⁹

It was possible to have a situation where the Chairman is merely a figurehead and the General Manager is the one in control.⁷⁰ As a Shanghai-based international corporate governance advisor explained, '[i]n general, you have two models of Chairman: one where the Chairman's job is political and the individual is a political person. Then you have a president or a CEO who is more technocratic'.⁷¹ However, as a lawyer in Beijing suggested, in large companies, it was more common for the Chairman, rather than the General Manager, to be the person in control.⁷²

⁶⁶ Interview code QD02417.

⁶⁷ Interview code SH09617.

⁶⁸ Interview code BJ02006 (b).

⁶⁹ Interview Code SH09806 (a).

⁷⁰ For example, in a Shanghai-based electronics company, '[t]he Party leaders are not very involved in business decisions but they may have an opinion on some matters particularly in human resources. Overall, the General Manager has control' (Interview code SH03515).

⁷¹ Interview code SH08006 (a).

⁷² Interview code BJ0328.

This 'key man model' does not necessarily lead to poor corporate performance.⁷³ As a regulator in Hong Kong pointed out, it allows issues at corporate level to be dealt with 'swiftly and decisively', which may be translated into strong performance.⁷⁴ Further, according to some interviewees, strong state involvement in the management of listed companies may also facilitate the implementation of state economic policies.⁷⁵ This, as Chapter 3 discussed, is a fundamental role of corporate governance in a state-led economy.

However, as the ARC project interviews suggested, the above practicalities of this model may be undermined by many risks associated with this model. The concentration of corporate decision-making power in one, or a few, insiders was susceptible to abuse, which might further jeopardise effective state control of companies. As an official of the Shanghai Stock Exchange put it, 'CEOs use a lot of company resources for their own benefit, due to lack of monitoring by the state shareholder. They abuse their powers'.⁷⁶

A number of factors may have contributed to the poor monitoring of listed companies' executives and their parent SOEs. According to agency theory of the firm as discussed in Chapter 2, effective corporate governance depends on the interaction of a wide range of internal mechanisms (such as shareholding monitoring, mandatory disclosure of information, independent directors and executive remuneration) and external mechanisms (such as the market for corporate control, labour market and outsider participation).⁷⁷ From the ARC project interviews, extensive corporate powers vested in the general meeting (essentially the controlling shareholder) and the Chairman, coupled with a situation in which the state is the controlling shareholder, significantly weakened the internal and external monitoring environments for the governance of listed SOEs.

⁷³ Among Chinese state-controlled companies, there had been some examples of a technocratic chairman who turned their companies from loss-making enterprises into world-class large businesses. One such example is Fu Chengyu, the Chairman of CNOOC, who led the company's bid for the Unocal in US in 2004. The importance of the quality of Chairman was also pointed out by the company secretary of an electronic appliance company 'Retail investors are not doing a lot of research. They want to ask you how much you will report---more of a trading question. Institutional investors are willing to have a long term view. The key thing for them is the quality of the Chairman and the management. If the Chairman is someone they can trust, they would not be too bothered by other things' (Interview code SZ04511).

⁷⁴ A Hong Kong regulator (Interview code HK06117).

⁷⁵ For example, a Hong Kong-based regulator observed, 'while the government is the majority shareholder in the company, directors see their role as being accountable to the government' (Interview code HK05917).

⁷⁶ Interview code SH08317.

⁷⁷ For example, G. P Stapledon, *Institutional Shareholders and Corporate Governance* (Clarendon Press, 1996).

First, a situation in which the parent SOE is the controlling shareholder, coupled with extensive managerial powers conferred on the general meeting and the Chairman, overrode the 'typical corporate governance checks and balances'.⁷⁸ This problem was described by the board secretary of a Qingdao-based electronics company in the following way:

In most organisations even in listed companies, only 1 or 2 persons make the decisions. So transparency talk is superficial. It is mainly big shareholders that control, like a private company.⁷⁹

The ARC project interviews suggested that many listed companies did not have an effective board. The role of the independent directors was described as 'symbolic'⁸⁰ by some interviewees, and 'advisory', by some others.⁸¹ The specialised board committees, mainly made up of these directors, were described by a Hong Kong-based corporate governance advisor as 'only providing a signature'. The role of the board of supervisors was seen by most interviewees as even less substantial than the independent directors. As a senior official from the CSRC explained, strong influence of the management and/or parent SOEs over the appointment of supervisors meant that the latter faced the problem of having to bite the hand that feeds them.⁸²

Ineffective internal governance aside, the state as a dominant shareholder further contributed to lax external monitoring of senior executives in listed SOEs. First, although the state and the parent SOE were often treated as one, there was a substantial divergence of interests between them. This point was made by a former Hong Kong stock market regulator (as well as senior advisor to the CSRC), when asked to comment on the impact of the state as a dominant shareholder on the governance of listed companies:

⁷⁸ A Hong Kong-based corporate governance advisor (Interview code HK05417); As an official from the Shanghai Stock Exchange also stated, when asked to comment on the impact of single large shareholder control on the accountability of directors, 'In China, members of the board see themselves as only representing interests of the dominant shareholder which has nominated them' (Interview code SH09620).

⁷⁹ Interview code QD02415.

⁸⁰ Interview code BJ02122; 'A nice vase of flowers on the table' (Interview code SZ04522) and 'trophies for directors and the company' (Interview code HK06022) were some of the phrases used by the interviewees to describe the role of independent directors in Chinese listed companies.

⁸¹ The company secretary of a Shenzhen-based company expressed a widely held opinion on independent directors: 'Generally speaking, independent directors in China are more like consultants. They often come from academic backgrounds. They are chosen by the board of directors and approved by shareholders. They usually don't vote against the board. Their role might become more important as the law will be stricter on them. But generally, I don't expect that they can play much of a role' (Interview code SZ04522).

⁸² This CSRC official stated, '[we] were told by some supervisory board members that they face two dilemmas. First, as company employees, the supervisors usually do not enjoy equal position with management. Second, as paid employees, they cannot be truly independent of the companies' (Interview code SH09206(c)).

The parent company is not the state but an interest group interested in staying out of trouble with government. The 'state' is a diffused notion and the regulatory bodies reflect it.⁸³

This divergence of interests was also observed by the board secretary of a Shanghai-based pharmaceutical company:

The state as the dominant shareholder affects corporate governance in listed companies. Where the state is a shareholder, it lacks representation in the listed companies which are controlled by insiders. The parent company will not benefit from dividends received from the listed company, as all dividends have to be handed over to the state. So there is not enough incentive for the parent company to look after shares in the listed companies on behalf of the state. Further, as parent SOEs won't benefit from managing those shares, they always try very hard to profit from abusing other shareholders.⁸⁴

The divergence of interests between the central and local governments was illustrated by an insider of a Shanghai-based company:

The central government does not want the state as a dominant shareholder to have any adverse impact on corporate governance. But local governments may use their status as a state shareholder to manipulate the companies. This is unavoidable.⁸⁵

The 'diffused notion of the state' as expressed in these statements is, in a sense, not different from the classical agency problems associated with state ownership of enterprises, namely, the 'absentee owners' and 'multiple-agency' relationship.⁸⁶ As discussed in Chapter 2, these problems, according to agency theorists, pose significant obstacles for effective state control and monitoring of managers.

The diffused notion of the state aside, another factor that affected external monitoring of corporate governance was the overlapping and conflicting roles of the state as a controlling shareholder, a regulator and developer of the Chinese stock market. First, state involvement in business decisions and government protection of companies and their managers significantly weakened legal enforcement by the CSRC and the stock exchanges. The functioning of these law enforcement agencies was affected by various other factors, such as the lack of experience and resources (which were associated with

⁸³ Interview code HK05517.

⁸⁴ Interview code SH08417.

⁸⁵ Interview code SH09117.

⁸⁶ See Michael Whincop, *Corporate Governance in Government Corporations* (Aldershot, Ashgate Publishing, 2005); *OECD Guidelines on the Corporate Governance of State-owned Enterprises* (2005), Preamble, 3. Andrew Yuen and Anming Zhang, 'An Economic Perspective on Recent Corporate Governance Developments in China with Comments on Chapters by Yang, Gu and Wang' in Masao Nakamura (ed), *Changing Corporate Governance Practices in China and Japan: Adaptations of Anglo-American Practices* (Palgrave Macmillan, 2008) 63.

the underdeveloped nature of the Chinese stock market), and (as will be discussed next) their relatively few sanctioning powers. However, where a business decision of the listed company was made with the full knowledge or involvement of its state-owned parent and other government agencies, there was a practical difficulty for the CSRC to ascertain and assign liabilities. As the board secretary of a Shanghai-based company put it, '[d]irectors are appointed by the majority shareholders and mainly represent the interests of the state'.⁸⁷ For the CSRC, this meant in order to pursue a director, it 'has to fight whoever is behind'.⁸⁸ In this respect, as Chapter 6 will further illustrate, the Chinese system of 'Party management of cadres', through its pervasive reward and sanction mechanisms, provided some rather intrusive means to discipline Party-appointed managers.⁸⁹ This system, however, overshadowed the power that the CSRC could exercise over those managers. As this point was made by the company secretary of a Guangdong-based power company:

In China, we have a tradition that cadres—including senior managers in state-owned companies—are regulated by the Party. Most senior management members are appointed by the organisational department of the central or local Party Committees. Therefore the CSRC has little role to play in the appointment and regulation of senior management members.⁹⁰

Second, weak legal enforcement was also contributed to by the dual role of the CSRC as a corporate regulator, as well as developer of the stock market in China. This latter role mainly stemmed from the original design of the Chinese stock market, namely, to raise funds for corporatised SOEs. To achieve rapid and stable development of the market, the CSRC needed from time to time to assist the central government to adjust the market through various policy tools⁹¹ including selective legal enforcement. This was especially so during prolonged bearish markets. The adoption of these tools inevitably diminished the rigor of the CSRC in disciplining the market and corporate managers. This was pointed out by a Hong Kong-based corporate governance researcher, when asked to comment on the degree of flexibility in CSRC's enforcement of its rules against directors:

⁸⁷ Interview code SH08440.

⁸⁸ Statement made by the board secretary of a listed bank (Interview code HK04240).

⁸⁹ Barry Naughton, 'China's Distinctive System' above n 21, 456.

⁹⁰ Interview code GZ10232.

⁹¹ 邹光祥, 张勇 [Zou Gangxiang and Zhang Yong], '证监会权衡系列救市政策 必要时百亿资金将入市' [CSRC Considering Policy to Save the Market: RMB10 billion to be Injected into the Market if Necessary] *Financial Observer* (online) (22 January 2005) <<http://finance.sina.com.cn/stock/y/20050122/16421314883.shtml>>. The article provided a list of various measures undertaken by the CSRC in rescuing the market since the establishment of the stock market in China.

It is partly a political answer. A couple of years ago, they did go after a number of directors. But since the bubble burst and market fell, CSRC has been very defensive. CSRC gets blamed if the market falls etc. So, people do not like to work there if they want to climb the ladder in China. CSRC does see itself as nurturing the market and so coming out hard on directors may be seen as unfair. The incentive is to take a 'softly-sofly' approach.⁹²

This dualism in the roles of bodies such as the CSRC, which simultaneously needed to support the state economic policy and engage in law enforcement, appeared to be a recurring theme in the ARC project interviews. As law enforcement agencies, the CSRC, the stock exchanges, and the courts, shouldered the responsibility to discipline listed companies and to protect investors from corporate/managerial malfeasance. Yet, as part of the government apparatus, all three bodies had to support the state's economic policy, including the policy to promote development of the Chinese stock market as an important source of equity financing for SOEs. This dualism may have played an important role in promoting the rapid growth of the stock market in China, which significantly outpaced other emerging economies such as Russia.⁹³ However, it diminished the willingness of various law enforcement agencies to discipline corporate managers and parent SOEs, which may further undermine good corporate governance in listed SOEs.

The above analysis showed that state involvement in corporate management was an important feature of the law and practice concerning state-manager relations within large listed SOEs in China prior to 2005. Indeed, backed by a situation in which the state was the controlling shareholder and Party-state appointment of top corporate executives, state intervention in corporate decision-making in Chinese listed SOEs seemed to be far more evident than the former post-war state-led model of corporate governance. Nevertheless, as this section has also demonstrated, the paradoxical co-existence of state intervention and insider control may not have served the two-fold goal of the state in relation to these large companies, namely, to improve corporate management without the state losing ultimate control. As Chapter 6 will illustrate, the search for an effective solution to these problems, particularly the problem of insider

⁹² Interview code HK05440; An even more negative view was expressed by the company secretary of Beijing-based resource company, 'Corporate governance is not a hot topic for CSRC now, as no higher-ranking officials talk about it any longer. 'A' share listed companies are not under pressure and the investors are not mature' (Interview code BJ01637). This comment was made in the context of a prolonged bearish market that had its inception in the release of the *Temporary Measures on Raising Social Security Fund through Reduction of State Shares* on 14 June 2001 and the subsequent experiment of reduction of state shares through securities market. See 邹光祥, 张勇 [Zou Gangxiang and Zhang Yong], above n 91.

⁹³ Katharina Pistor and Chenggang Xu, 'Governing Emerging Stock Markets: Legal vs. Administrative Governance' (2005)13 *Corporate Governance: An International Review* 5, 6.

control, underpinned many Chinese post-2005 legal and regulatory reforms concerning state-manager relations in these companies.

5.4 Investor protection

Having considered state-manager relations, this section and section 5.5 examine the law and practice concerning minority shareholder and other stakeholder protection in listed SOEs prior to the 2005 corporate law reforms. The two sections will show that, while China's pre-2005 legal and regulatory frameworks concerning these two areas reflected some key features of the former state-led model, poor protection of investors was far more common and serious in Chinese listed SOEs.

5.4.1 The legal and regulatory framework

Consistent with the former state-led model, minority shareholder protection was a priority for neither the 1993 *Company Law* nor the 1998 *Securities Law*.⁹⁴ This was despite the fact that 'to protect the legitimate rights and interests of the shareholders' was one of the pronounced legislative aims in both statutes.⁹⁵

On the surface, the two statutes stipulated some broad powers for shareholders. For example, the 1993 *Company Law* provided that shareholders, as capital contributors, 'shall have the rights to enjoy capital gains, make major policy decisions and select management personnel' in proportion to their shareholdings.⁹⁶ The 1993 *Company Law* also provided shareholders with some other rights such as the right to vote at shareholder meetings in person or by proxy, and to make recommendations about company operations.

Most of these broad powers were, however, more relevant to the controlling shareholders than the small public investors. This was, in part, due to the lack of provision in the *Company Law* on how those powers could be exercised by shareholders and, in part, to the absence of effective shareholder remedies. Among the few provisions relevant to the latter, Article 111 broadly provided that shareholders had the right to sue where 'a resolution of the shareholders meeting or the board of directors has violated the law, administrative decrees or encroached upon the legitimate rights of

⁹⁴ Baoshu Wang and Hui Huang, 'China's New Company Law and Securities Law: an Overview and Assessment' (2006) 19 *Australian Journal of Corporate Law* 229, 230.

⁹⁵ 1993 PRC *Company Law* art 1; 1998 PRC *Securities Law* art 1.

⁹⁶ 1993 PRC *Company Law* art 4 (1).

shareholders'.⁹⁷ This Article, however, provided little relief to an aggrieved shareholder. The only actionable wrongdoings under Article 111 concerned general meeting and board resolutions, and the only court order the shareholder could seek was 'to stop the infringement'.⁹⁸ This remedy has, therefore, been described by Zhang as 'focusing more on safeguarding the market order of the state, rather than on effective compensation to injured individual shareholders'.⁹⁹ Further, Article 123 broadly provided for directors' liability to compensate the company for their conduct in breach of the law, administrative regulations or the articles of association. This provision was, however, silent on any remedies that may be sought by aggrieved shareholders where their company is unable or refuses to sue the wrongdoer(s).¹⁰⁰ Neither an Australian-style shareholder derivative action¹⁰¹ nor an oppression remedy¹⁰² was available under the 1993 *Company Law*.

A similar approach was adopted by the 1998 *Securities Law* in relation to the issue of investor protection. Article 3 of the *Securities Law* broadly provided that 'securities issue and transaction shall adhere to the principles of openness, fairness and impartiality'.¹⁰³ This was complemented by Article 4 which stated that, '[t]he parties involved in the issuing and trading of securities shall have equal legal status and adhere to the principles of voluntariness, compensation and good faith'.¹⁰⁴ Article 59 required any documents prepared for public offering and listing of securities to be 'truthful, accurate and complete, and does not contain any false or misleading statement or material omission'.¹⁰⁵ The 1998 *Securities Law* also made some provisions for corporate disclosure. This included both periodic (namely, annual and half-year financial reports), and continuous disclosure on major events that may materially affect the company's share price.¹⁰⁶ In addition, the *Law* prohibited certain securities market-

⁹⁷ Ibid art 111.

⁹⁸ Ibid.

⁹⁹ Xianchu Zhang, 'Practical Demands to Update the Company Law' (1998) 28 *Hong Kong Law Journal* 248, 252.

¹⁰⁰ The CSRC *Code of Corporate Governance* supplements this provision by providing that 'the shareholders shall have the right to request the company to sue for such compensation in accordance with law'. *Code of Corporate Governance*, above n 4, art 4.

¹⁰¹ *Corporations Act 2001* (Cth) ss 236, 237.

¹⁰² Ibid s 232.

¹⁰³ 1998 PRC *Securities Law* art 3.

¹⁰⁴ Ibid art 4.

¹⁰⁵ 1998 PRC *Securities Law* art 59.

¹⁰⁶ Ibid arts 58-94. For a more detailed overview of the regulation of disclosure by Chinese listed companies, see Jane Fu, *Corporate Disclosure and Corporate Governance in China* (Wolters Kluwer, 2010) ch 5, 127-71.

related misconduct. These included insider trading,¹⁰⁷ manipulation of the securities market¹⁰⁸ and fabrication and dissemination of false information.¹⁰⁹ Various administrative and criminal liabilities were imposed on companies, and senior executives, for certain conduct which breached the *Securities Law*.¹¹⁰

The remedies offered by the 1998 *Securities Law* to investors who had suffered loss were, however, both few and illusory. Securities-related false or misleading disclosure was the only cause of action for these investors. Article 63 provided that the issuers/underwriting securities companies should be liable for the losses caused by false or misleading disclosure to investors, and that responsible directors, supervisors and officers in the listed companies/underwriting securities companies should be jointly liable.¹¹¹ However, as Chapter 7 will further illustrate, following a series of judicial opinions issued by the SPC, this action was made available to aggrieved investors only where the alleged wrongdoing had been subject to an administrative sanction, or a criminal conviction.¹¹² Shareholder class actions are banned in China due to another judicial opinion issued by the SPC in 2002. This will also be discussed below in Chapter 7.

As noted earlier, the CSRC has played the leading role in investor protection since the early 2000s. The *Code of Corporate Governance for Listed Companies* issued by CSRC, based on the *OECD Principles of Corporate Governance*, provides a number of principles concerning shareholders' rights and equal treatment of shareholders. In response to the prevalence of group affiliation among listed companies, the CSRC *Code* requires that listed companies be separate from their controlling shareholders in personnel, assets and financial matters.¹¹³ The *Code* also sets some behavioural rules for various corporate organs of listed companies, and their controlling shareholders. Unlike

¹⁰⁷ 1998 PRC Securities Law arts 67-70.

¹⁰⁸ Ibid art 71.

¹⁰⁹ Ibid art 72.

¹¹⁰ Ibid arts 175, 177, 202; 《中华人民共和国刑法》 [Criminal Law of the People's Republic of China] (People's Republic of China) National People's Congress, 14 March 1997, arts 160, 161, 179, 180, 181 and 182.

¹¹¹ 1998 PRC Securities Law art 63.

¹¹² 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Several Provisions on Trial of Civil Compensation Cases Arising from Misrepresentation on the Securities Market] art 5.

¹¹³ CSRC Code of Corporate Governance, above n 4, arts 22-27.

Australian corporate law, it also imposes on controlling shareholders a duty of good faith to the company, and to other shareholders.¹¹⁴

The extent to which the CSRC and the stock exchange listing rules, as mentioned in Section 5.2, could provide an effective remedy to injured investors was, however, quite limited. First, the administrative regulations issued by the CSRC can be enforced only by the agency itself, through administrative sanctions such as warning, fines, suspension or termination of listing.¹¹⁵ Compared to the administrative regulations, the binding force of the CSRC *Code* is even weaker. Similar to a Western code of corporate governance, the *Code* does not detail any penalties for the violation of any compulsory rules it contains.¹¹⁶ Rather it states that the CSRC will use the *Code* to evaluate the governance structure and practice of listed companies, and may direct a company to make necessary corrections for any breach of the *Code*. The stock exchanges, as self-regulatory bodies, have even fewer sanctioning powers in enforcing the listing rules.

The above review of the pre-2005 regulatory framework for investor protection showed that the framework was far from rigorous. The examination of the underlying practice in the Chinese top 100 listed companies below will suggest that poor investor protection was further exacerbated by the overlapping roles of the state as a dominant shareholder, a market regulator and adjudicator of securities-related disputes.

5.4.2 Features of and problems with governance practices

As noted in Chapter 2, the muted voice of shareholders was a typical feature of the former state-led model of corporate governance. However, this does not necessarily imply that shareholders were ill-treated. Indeed, small individual shareholders in pre-mid-1990s Japan were depicted by Aoki as passive but placid outside investors, who customarily delegated their monitoring role to large and stable shareholders, such as the main banks.¹¹⁷ If this depiction can be used as a benchmark, the situation for public investors in Chinese listed SOEs pre-2005 appeared to be much worse.

¹¹⁴ Ibid art 19.

¹¹⁵ 1998 PRC Securities Law ch 12.

¹¹⁶ Some rules in the Code for Corporate Governance for Listed Companies in China are compulsory and others are statements of recommended practices.

¹¹⁷ Masahiko Aoki, 'Monitoring Characteristics of the Main Bank System: an Analytical and Developmental View', in Masahiko Aoki and Hugh Patrick (eds), *The Japanese Main Bank system* (Oxford University Press, 1994) 109, 128.

First, poor investor protection was manifested in inadequate information disclosure by listed companies. When asked to comment on the effectiveness of the system of corporate disclosure in China, references such as 'minimal disclosure', 'formal compliance' and 'lack of material disclosure' were frequently used by the interviewees. For example, a financial investment consultant in Shanghai stated, 'they disclose what is asked for and no more. Sometimes they will disclose less'.¹¹⁸ The problem of false disclosure was highlighted by a financial journalist in Shanghai:

There has been progress in information disclosure. Companies know they have to disclose regularly. The problem is whether they disclose the right information. Sometimes, they hide the true information. Auditors can be bribed. They work with the company to give wrong information. You need to have other measures to make it work.

For some interviewees, the truthfulness of information disclosed by listed companies also attracted concern from the stock exchanges. Some statistics given by a corporate governance adviser in Hong Kong shed light on the seriousness of the problem:

PRC is one of the few markets with quarterly reporting. It improves the efficiency of reporting and financials. But how well are these financials checked? Two years ago, 84 companies were checked and over 80% of these companies and over 70% of the auditors had inaccuracies. This makes you think twice about accepting the financials.¹¹⁹

Second, poor protection of investors was also reflected in the rampant diversion of funds by parent SOEs from listed companies. This was consistent with a survey conducted by the CSRC in 2002, which found that diversion of funds by controlling shareholders occurred in 676, or more than half, of listed companies, with the total amount of funds diverted amounting to nearly RMB97 billion (approximately AUD15 billion).¹²⁰ This phenomenon led an accounting professor in Shanghai to use the term 'ATM (Automatic Teller Machine)' to describe the status of listed companies in relation to their parent enterprises.¹²¹

¹¹⁸ Interview code SH08037.

¹¹⁹ These figures seem to be consistent with a more recent study which found that the CSRC imposed sanctions in relation to 49 cases of violation of securities law in 2004 and, 43 in 2005. More than half of these cases involved false disclosure. The study further estimated that 'for every one case of penalty or public censure there are as many as four cases of violation that have not been revealed or pursued'; Zhong Zhang, above n 28, 754.

¹²⁰ '重建股市生态平衡' [Re-establishing the Ecosystem Balance of the Stock market], *China Net News Story* (9 September 2003) <<http://www.china.org.cn/chinese/OP-c/400605.htm>>.

¹²¹ Interview code SH09311.

The most common means of diversion of funds, according to some interviewees, was through related party transactions.¹²² As most listed companies were derived from their parents, the upstream and downstream business connections between the parent and subsidiary companies necessitated this type of transactions. In the meantime, as the parents had injected their most profitable line of business into the subsidiaries for the specific purpose of listing, there was also an expectation that the favour rendered would subsequently be returned. This rationale was observed by the board secretary of a Beijing-based company:

Those people who were left with the non-performing assets have to make a living. Their factories are losing money. This is the problem. They have to use connected transactions to channel profits of listed companies to the remaining entity.¹²³

Of course not all listed companies and their parent SOEs treated their public investors poorly. A large listed company might have provided them with better treatment because the company was well-known, and hence 'pays more attention to its reputation'¹²⁴ or simply that the listed company had a rich parent. For example, when asked to comment on how minority shareholder interests were usually protected in Chinese listed companies, the board secretary of a power company in Guangdong remarked:

Generally it needs improvement. However, in our case, the parent company is well off and it does not need to siphon funds from the listed company. Sometimes, it even gives some extra benefits to the minority shareholders. So the situation (for shareholder protection in our company) has been good.¹²⁵

Chinese companies listed on foreign exchanges were also perceived by the majority interviewees as having better corporate governance and investor protection.¹²⁶ This was largely attributed to the stronger discipline provided by foreigner regulators and market participants.¹²⁷ For example, when asked to comment on the impact of foreign listing of

¹²² As an executive of a Shandong-based textile company stated, '[w]e feel that in other companies there are a lot of connected transactions. In China, the equity market is used for financing transactions, not for return. We think the HK market is better in this respect' (Interview code SH09412).

¹²³ Interview code BJ01307 (b).

¹²⁴ The in-house legal counsel of a listed insurance company (Interview code BJ06812).

¹²⁵ Interview code GZ10212.

¹²⁶ As a researcher of the Shenzhen Stock Exchange stated, when asked whether listing of Chinese companies on foreign exchanges would improve the quality of corporate governance practices in China, 'That may occur. For example, public companies listed in New York improved their corporate governance after listing. Also when they list overseas, they come back and list in China. It helps with the improvement of corporate governance here' (Interview code SZ04544).

¹²⁷ As a Beijing-based partner of an international accounting firm stated, when asked about the impact of foreign listing on the impact of corporate governance practices in China, '[b]ecause there are foreign regulators and foreign intermediaries. The quality of disclosure is higher and reliability is higher'. (Interview code BJ07244).

Chinese companies on the improvement of the quality of corporate governance practices in China, the board secretary of a Qingdao-based company stated:

It has a positive effect. Overseas stock exchanges have better monitoring systems and their rules have to be followed when Chinese companies go overseas. Overseas listing also changes the mind/perspectives of the people involved.¹²⁸

However, due in part to the small number of PRC companies listed overseas prior to 2005, the demonstration effect of overseas listing on the governance of domestically listed companies was considered by some interviewees as 'extremely mild'.¹²⁹

Many factors contributed to the poor protection of minority shareholders in listed SOEs prior to the 2005 corporate law reforms. These included the concentrated share ownership structure in these companies, inadequate shareholder remedies, and the lack of resources and experience of the regulators, including the CSRC and Chinese courts, in dealing with securities-related claims. The overlapping and conflicting roles of these law enforcement bodies have been discussed in section 5.3. During the ARC project interviews, the lack of independence of the courts from government was also expressed by some interviewees as having contributed to their reluctance to hear securities-related claims filed by individuals.¹³⁰ For a senior executive of a Guangdong-based power company, Chinese courts may distance themselves from cases involving listed companies because of concerns about causing social 'disorder'.¹³¹

There were strong sentiments for change manifested in the ARC project interviews. A strong dissatisfaction with shareholder protection in listed companies in China was expressed by many interviewees, particularly in the regulatory, professional and academic sectors. For some interviewees, poor investor protection was the root cause for the lack of investor confidence in the Chinese stock market.¹³² The latter further led to the adoption of a highly speculative approach to investments not only by small individual investors, but also by institutional investors, including the QFIIs. For

¹²⁸ Interview code JN02344.

¹²⁹ Interview code HK05444.

¹³⁰ As an official of the CSRC stated, '[c]ourts are not independent from local government or competent in dealing with securities litigation' (Interview code SH08312).

¹³¹ Interview code GZ10242.

¹³² As a senior official of the CSRC stated, '[o]f course shareholders hope companies to have good corporate governance, but in fact many shareholders have lost their confidence in listed companies' (Interview code SH08609).

example, when asked to comment on the impact of the QFIIs on corporate governance practices in China, the board secretary of a technology company in Shanghai stated:

Their role is only symbolic at the moment. Firstly, the QFIIs hold only a small fraction of domestic shares (US\$36million). Secondly, they have adopted the same strategy as local funds, i.e., buying and selling quickly. At present, they cannot be called 'strategic investors' in China. The quotas obtained by QFIIs are subdivided and sold to other foreign institutions, so no one has a substantial shareholding.¹³³

Some interviewees considered poor investor confidence as a main factor for the long bearish market between 2001 and 2005.¹³⁴ For example, a corporate governance consultant in Hong Kong remarked:

... You are completely mad to buy in China today. It is a bizarre situation. With the economic growth, there is a lot of money available in China. But [the] securities market is mediocre.

Given the widespread public dissatisfaction, it is of no surprise that investor protection became one of the central issues for the 2005 corporate law reforms.

5.5 Non-shareholder stakeholder protection

As Chapter 3 discussed, the muted voice of non-shareholder stakeholders, such as consumers and local communities in which companies operate, was also a typical feature of the former state-led model of corporate governance. A notable exception in this regard was the treatment received by employees. Viewed as corporate insiders, rather than outsiders as in the Anglo-American outsider-based corporate governance, employees were often the target of state coordination. As the review of the law and practice in relation to non-shareholder stakeholder (including employees) protection in the top 100 listed SOEs during 2002 to 2004 below will demonstrate, this feature of the former state-led model was also present in China prior to the 2005 corporate law reforms.

5.5.1 The legal and regulatory framework

In relation to employee protection, in line with the Chinese socialist tradition as well as the former state-led model, Article 15 of the 1993 *Company Law* mandated that 'a company shall protect the legitimate rights and interests of its staff and workers,

¹³³ Interview code SH09145.

¹³⁴ For example, the company secretary of a Shanghai-based iron and steel company remarked, '[companies] have not done enough to protect minority shareholders. Otherwise the stock market would not remain sluggish for so long and there would not be so many scandals exposed by the media' (Interview Code SH09212).

strengthen labour protection, and ensure safe production'.¹³⁵ Companies were also required to improve the productivity of their workers through various means, such as undertaking 'vocational education and in job training'.¹³⁶ Article 16 further stated that, '[w]orkers of a company shall organise a trade union organisation in accordance with the law to carry out union activities and safeguard worker's legitimate rights and interests. A company shall provide the necessary conditions for activities of its trade union organisation'.¹³⁷

Consistent with the strong representation of employees in traditional SOEs, the role of employees was also 'institutionalised' in the structure of corporate governance.¹³⁸ For example, Article 124 provided that the supervisory board must consist of an 'appropriate proportion of workers'. Article 121 required companies to consult with trade unions and employees when making decisions concerning employee wages, welfare, safe production processes and other issues related to the employees' interests.¹³⁹ Companies were further required to consult with trade unions and employees when deciding significant operational issues under Article 122.¹⁴⁰

However, beyond employee protection, the concept of corporate social responsibility appeared to have only been 'partially embedded' in the *1993 Company Law*.¹⁴¹ Article 14 vaguely provided that the company 'shall abide by law, observe business ethics, promote socialist culture and ethics, and accept the supervision by the government and the public'.¹⁴² Citing a leading Chinese corporate law professor, Lin argued that the lack of clear emphasis of corporate social responsibility in the *1993 Company Law* occurred in a context where the government 'vehemently helped SOEs shirk debt and extricated them from the function of social services'.¹⁴³ It was not until 2002 that the concept of 'corporate social responsibility' was introduced into China through the *Code of Corporate Governance* issued by the CSRC. The *Code* broadly requires that 'while

¹³⁵ 1993 PRC Company Law art 15(1).

¹³⁶ Ibid art 15(2).

¹³⁷ Ibid art 16(1).

¹³⁸ Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' (2010) 28 *Berkeley Journal of International Law* 64, 68.

¹³⁹ 1993 PRC Company Law art 121.

¹⁴⁰ Ibid art 122.

¹⁴¹ Li-Wen Lin, above n138, 69.

¹⁴² 1993 PRC Company Law art 14(1).

¹⁴³ 刘俊海 [Liu JunHai], 《公司的社会责任》 [Corporate Social Responsibility] 北京法律出版社 [Beijing Law Press], (1999) 85-86, cited in Lin, Li-Wen, above n 138, 69.

ensuring sustained growth and maximising shareholder interests, listed companies shall be committed to community welfare, environmental protection and charity issues and shall pay attention to their company's social responsibilities'.¹⁴⁴

However, as the review of the ARC project interview data below will suggest, similar to the former state-led model, the practice of non-shareholder stakeholder protection in Chinese listed SOEs rarely went beyond the protection of employees during 2002 to 2004.

5.5.2 Features of and problems with governance practices

From the ARC project interviews, similar to the post-war state-led economies, employees were generally treated as important stakeholders in large listed SOEs in China. As discussed below, the degree of employee protection offered by state-controlled listed companies was not seen as very different from the traditional SOEs under the planned system. This seems to be an interesting contrast to the widely-held view among Western researchers at that time that the model of corporate governance in Chinese companies was quickly converging with the Anglo-American model.

The relatively strong employee protection offered by state-controlled listed companies, in comparison to their private-sector counterparts,¹⁴⁵ was attributed by several interviewees to the legacy of the traditional SOEs. For example, a Shanghai-based auditing partner of an international accounting firm remarked, '[c]ompanies that used to be SOEs have a tradition of protecting people. For a long time, this is a traditional morale that employees are very important to company success'.¹⁴⁶ For several other interviewees, the importance placed by the Party-government on maintaining social stability was another important factor.¹⁴⁷

The need for protecting the interests of employees appeared to have led some insiders from the top 100 to take a much broader view of the concept of corporate governance. The level of employee protection was seen by these corporate executives as an

¹⁴⁴ CSRC Code of Corporate Governance, above n 4, art 86.

¹⁴⁵ As a company secretary of a Beijing-based oil company remarked, 'for some private companies, they are using workers ruthlessly as labour in China is in oversupply... There are lots of factories in Southern China with lots of labours working in harsh conditions' (Interview code BJ01313).

¹⁴⁶ Interview code SH07913.

¹⁴⁷ For example, a Beijing-based law academic remarked, 'for our government the protection of employees is the most important thing, as government seeks to keep the society stable and enhance people's living standards' (Interview code BJ01913). Similarly, an official from the Shanghai Stock Exchange stated, '[t]he interests of employees are very important as government wants to keep social stability' (Interview code SH09613).

important indicator of good corporate governance.¹⁴⁸ Several interviewees also believed that the level of employee protection offered by state-controlled listed companies far outweighed the protection they provided for minority shareholders.¹⁴⁹

The relatively good protection afforded by state-controlled listed companies to their employees is, however, different from a strong voice given to the employees. Indeed, compared to their status as 'masters of the enterprises' under the former planned system, there was a general trend towards weakening the voice of workers in corporate governance during the period of 2002 to 2004. Employee representatives on the supervisory board did not play any substantial monitoring role, and the trade unions generally served as a tool of the Party to maintain labour peace and unity with the Party. This latter point was made by an informant from a Shanghai-based bank:

Because of differences in social structure, unions in China play a different role compared to unions in Australia. In China, unions facilitate company goals. In most situations, this benefits employees and does not conflict with management.¹⁵⁰

According to some interviewees, the coincidence of the interests of the employees with those of the Party, and company management, might have played an important role in facilitating state goals. This is especially so with the shift in focus of the Party from ideology building towards economic growth. This was explained by an informant from a Shanghai-based electric company:

Elements of the old system (like the Party) still exist, but their functions have changed a lot. The new role of the Party in listed companies is to facilitate things and to build stability of the company. The board is more concerned with the operation of the company. Both the Party and the board want the company to run smoothly. Like the Party, unions are more in a supporting role in the daily operations. The concept of unions in China is different from the West. In China it cooperates with the company.

Furthermore, consistent with the former state-led model, non-shareholder stakeholder protection beyond employee welfare was largely ignored prior to the 2005 *Company*

¹⁴⁸ As this point was illustrated by the company secretary of a Chongqing-based company: 'The protection of employee interests is a fundamental concern for good corporate governance... Also according to the policy of the government and the Party, rights and interests of employees in the state-owned companies must be protected. We have entered into a contract with the union in our company which specifies measures the management shall adopt to safeguard and enhance employees' interests. As the company's profits have increased in recent years, employee welfare has also improved' (interview code CQ10313). A Shanghai-based accounting professor and independent director also agreed, 'Companies that used to be SOEs have a tradition of protecting people. For a long time, this is a traditional morale that employees are very important to the company's success' (Interview code SH07913).

¹⁴⁹ As a Shanghai-based financial industry advisor remarked, 'Employee interests are so well protected by others, like the Party, the Government and the Union... In the current situation, the protection of interests of employees is outweighed at the expense of shareholders' (Interview code SH08013).

¹⁵⁰ Interview code SH03416.

Law reform. When asked to rank company stakeholders, some interviewees noted customers and suppliers. However, few corporate insiders identified the interests of the local community, or the wider public, as important company stakeholders.

5.6 Conclusion

This chapter has examined the regulatory environment concerning the governance of Chinese listed SOEs prior to the 2005 corporate law reforms. It has also examined the law and practice in relation to three sets of company relations (namely, state-manager relations, investor protection and non-shareholder stakeholder, including employee protection) central to the former post-war state-led model of corporate governance, within large Chinese listed SOEs during 2002 and 2004. As this chapter has demonstrated, as well as the overall regulatory environment, the regulatory framework for those three sets of company relations during the period examined resembled some key features of the former state-led model. These included state involvement in management decision-making, the muted voice of shareholders and poor non-shareholder stakeholder protection that rarely went beyond employee welfare.

While the underlying practice of corporate governance in China largely conformed to the former state-led model, some serious problems in this regard may have jeopardised the future development of these companies. In relation to state-manager relations, this chapter has shown that, backed by state ownership of large companies and Party-state appointment of top corporate executives, state intervention in company management appeared to be far greater in China compared to the former state-led economies. Nevertheless, excessive powers vested in the general meeting and the Chairman of the board of directors, coupled with lax internal and external monitoring of the exercise of those powers, led to the paradoxical problem of insider control of listed companies by their top executives and parent SOEs. In relation to investor protection, compared to the former East Asian state-led economies such as Japan, the exploitation of minority shareholders by controlling shareholders and corporate managers appeared to be far more common and serious in Chinese listed SOEs. Similar to the post-war state-led economies, non-shareholder stakeholder protection in these companies was largely confined to the protection of employee interests.

As explained in Chapter 3, institutional, including corporate governance, changes in state-led economies face the dual pressures of economic globalisation and the pluralisation of interests within domestic society. Under these pressures, subsequent

governance reforms carried out in China could have propelled Chinese corporate governance to move towards the Anglo-American outsider-based model. However, as the review of the theories of state capitalism and institutional change in Chapter 3 suggested, the state plays an important role in conditioning the trajectory of changes in the formulation and enforcement of corporate governance rules in state-led economies. A centralised state may choose to respond to these challenges by readjusting its relations with key corporate actors and, in the meantime, taking into account other interests emerging in companies and the wider society, without necessarily resorting to a fundamental systemic change.

The next three chapters will illustrate this point by examining China's post-2005 legal and regulatory reform of the above three sets of company relations concerning listed SOEs. Through identifying and interpreting the changes, and continuities thereof, the three chapters will illustrate the emergence of a new 'state-led stakeholder' approach to the governance of listed SOEs in China.

CHAPTER 6 CHANGES AND CONTINUITIES IN CHINA'S POST-2005 REGULATION OF STATE-MANAGER RELATIONS

6.1 Introduction

The next three chapters, including this one, examine China's post-2005 legal and regulatory reforms of corporate governance in listed state-owned enterprises (SOEs). This chapter focuses on state-manager relations, Chapter 7 on investor and other stakeholder, including employee, protection. Chapter 8 interprets the changes and continuities in the Chinese post-2005 regulation of these three sets of company relations through the lens of state capitalism and institutional change.

Put together, the three chapters will show that China's post-2005 regulatory framework has given rise to a new model of corporate governance, which can be called a 'state-led stakeholder' approach. On the one hand, the model has moved away from the former state-led model, which was partly manifested in pre-2005 Chinese corporate governance, in three important aspects. First, the state has intensified efforts to strengthen monitoring of managers. As discussed in Chapter 5, insider control by top executives and parent SOEs was one of the key problems with corporate governance in listed SOEs prior to 2005. This chapter will demonstrate that in an effort to strengthen monitoring of managers, China has adopted many mechanisms of the Anglo-American outsider-based corporate governance. This trend of market-oriented changes is likely to accelerate under a new generation of Chinese leaders. Second, compared to the former state-led model, the new Chinese model represents a far more shareholder-friendly approach. As will be shown in Chapter 7, drawing upon Anglo-American corporate governance, this model provides minority shareholders with additional protection, at least as regards the law-in-the-books. Third, adopting an all-encompassing approach, and drawing upon the broader stakeholder model of corporate governance, this model attempts to provide a wide range of other non-shareholder stakeholders with far better protection than China's pre-2005 regulatory framework.

On the other hand, despite these extensive changes, the new Chinese model remains a state-centric approach. As these chapters will also demonstrate, a large and visible role continues to be played by the state in structuring company relations with its internal and external stakeholders. In relation to state-manager relations, this chapter will show that, taken together with the non-market-based changes and the substantial continuity in the

Chinese post-2005 regulatory framework, the various market-based changes have been utilised to strengthen the effectiveness of state control over corporate managers, rather than to distance the state from SOEs.

The remainder of the chapter is divided into four sections. Section 6.2 provides an overview of the 2005 major amendments¹ to the 1993 *Company Law* and the 1998 *Securities Law*. This is because these two amendments lie at the heart of China's corporate governance reforms over the past few years. Section 6.3 outlines the main changes to the regulation of state-manager relations in listed SOEs introduced by the new *Company Law* and the *Securities Law* and related regulatory reforms. Given the group affiliation nature of most listed SOEs in China (as Chapter 5 discussed), state-manager relations within listed companies cannot be separated from those at the parent SOE level. Section 6.3 will therefore look at the regulatory changes at both levels. As this section will suggest, in regard to the latter, the State-owned Assets Supervision and Administration Commission (SASAC), as the regulator and state shareholder of central government-affiliated SOEs (central SOEs), has played a key role in initiating changes. Section 6.4 identifies the continuities in China's post-2005 regulation of state-manager relations. Putting together the main findings of this chapter, Section 6.5 summarises the key features of Chinese post-2005 regulation of state-manager relations concerning listed SOEs.

6.2 Overview of the 2005 Company Law and Security Law reforms

Regulation of corporate governance in China has undergone extensive changes since around mid-2000s. The key actors in the regulatory environment, as outlined in Chapter 5, have largely remained the same. However, substantial changes have taken place to the regulatory framework, particularly through the 2005 *Company Law* and 2005 *Securities Law* amendments.

These two long-awaited amendments were driven in part by the development of Chinese economy, and partly, popular demands of society.² As discussed in Chapter 4,

¹ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005 ('2005 PRC Company Law'); 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005 ('2005 PRC Securities Law').

² 周正庆 [Zhou Zhengqing], '关于《中华人民共和国证券法(修订草案)》的说明' [Explanation of the Draft Amendment to the Securities Law of the People's Republic of China] (Delivered at the 15th Meeting of the 10th National People's Congress Standing Committee, 24 April 2005) <http://www.npc.gov.cn/wxzl/gongbao/2005-10/27/content_5343116.htm>.

the 1993 PRC *Company Law* and the 1998 *Securities Law* were drafted to assist corporatisation of SOEs without necessarily removing state control. Consequently, both statutes were not only fraught with technical deficiencies associated with the early stage of the SOE reform, but also strongly favoured the interests of the state. As China's economic reform and opening-up progressed, both statutes were widely criticised for their failure to provide a corporate law system that would better facilitate development of companies in all sectors and the Chinese stock market.³

In response to this criticism, both the 2005 *Company Law* and 2005 *Securities Law* exhibit a broad trend of shifting away from a SOE-centred to a general company law statute, and from government control of corporate activities to free enterprise. For example, the 2005 *Company Law* has lowered the statutory capital requirements for incorporation,⁴ and allowed companies greater discretion to structure their internal affairs through constitution or resolutions of shareholders.⁵ Moreover, the new *Company Law* has abolished the ceiling for companies to invest in other companies⁶ and allowed incorporation of one shareholder/director limited liability companies.⁷ Some major changes introduced by the new *Securities Law* have also brought the Chinese securities regulatory regime more in line with China's WTO commitments and international practices.⁸

Strengthening corporate governance was, nevertheless, a key objective of the 2005 corporate law reforms. In the *Explanation of the Draft Amendment to the Company Law*⁹ produced by the State Council Legal Affairs Office (which prepared the initial

³ 曹清泰, '关于《中华人民共和国公司法(修订草案)》的说明'[Explanation of the Draft Amendment to the Company Law of the People's Republic of China] (Delivered at the 14th Meeting of the 10th National People's Congress Standing Committee, 25 February 2005) <http://www.npc.gov.cn/wxzl/gongbao/2005-10/27/content_5343120.htm>; 安健 [An Jian], '公司法的全面修订和修订的主要内容' [The Overhaul of the Company Law and the Main Contents subject to Major Revision] in 安健 [An Jian] (ed), 《中华人民共和国公司法释义》 [Annotated Company Law of the People's Republic of China] (China Law Press [法律出版社], 2005) 1; 周正庆 [Zhou Zhengqing], above n 2.

⁴ 2005 PRC *Company Law* arts 26, 81.

⁵ 2005 PRC *Company Law* art 101; Note to further encourage private investment, amendment to the PRC *Company Law* in 2013 removed the minimum registered capital requirements for incorporation of all types of companies in China. See 《中华人民共和国公司法修正案》 [Company Law of the People's Republic of China: 2013 Amendment] (People's Republic of China) National People's Congress Standing Committee, 28 December 2013.

⁶ 2005 PRC *Company Law* art 15.

⁷ 2005 PRC *Company Law* ch 2, Section 3 (arts 58-64).

⁸ Baoshu Wang, and Hui Huang, 'China's New Company Law and Securities Law: An Overview and Assessment' (2006) 19 *Australian Journal of Corporate Law* 229, 236.

⁹ 曹清泰 [Cao Qingtai], above n 3.

draft of the amendment), a State Council document calling for fostering steady development of the stock market through multiple means, including strengthening corporate governance,¹⁰ was cited alongside strong public concern for poor governance and investor protection in Chinese listed companies.¹¹ As will be discussed in this chapter and Chapter 7, many new provisions have been introduced through the revised *Company Law* and the *Securities Law* to enhance board accountability and effectiveness, as well as to address the various problems faced by minority shareholders (such as the lack of shareholders' rights and remedies) under the old framework.¹² That said, as illustrated in Section 6.4, the new *Company Law* has not removed most of the avenues for state involvement in corporate decision-making previously available under the 1993 *Company Law*.

6.3 Post-2005 regulation of state-manager relations: what has changed?

Significant changes have taken place in China's post-2005 regulation of state-manager relations. As this section will demonstrate, in an effort to reform this set of company relations, various market-based mechanisms based on Anglo-American corporate governance have been introduced not only into listed SOEs, but also their unlisted state-owned parent companies. Viewed in isolation, these changes might suggest that the regulation of state-manager relations in China is moving towards the Anglo-American outsider-based model. However, as discussed later, this may not be the case should these changes be taken together with various non-market-based changes, as well as substantial continuities in the Chinese post-2005 regulatory framework.

6.3.1 Regulatory changes to state-manager relations within listed SOEs

As discussed in Chapter 5, the governance structure established by the 1993 PRC *Company Law* was highly hierarchical. This structure, comprising the general meeting and two subordinate boards, was designed to preserve state control of corporate affairs, as it was envisaged that the state would remain the controlling shareholder in most of corporatised SOEs. However, with extensive management powers vested in the general meeting and the Chairman of the board of directors (the Chairman), and poor internal

¹⁰ The document mentioned in the *Explanation* is 《国务院关于推进资本市场改革开放和稳定发展的若干意见》 [Some Opinions of the State Council on Promoting the Reform, Opening and Steady Growth of Capital Markets] (People's Republic of China) State Council, 31 January 2004

¹¹ 曹清泰 [Cao Qingtai], above n 3.

¹² For an overview of the key areas of reform introduced by the 2005 *Company Law* and 2005 *Securities Law*, see Wang and Huang, above n 8, 232-8.

and external monitoring of the exercise of those powers, this structure contributed to the problem of insider control of listed SOEs by their top executives, particularly the Chairman, and parent SOEs.

This overall governance structure has not been significantly altered by the 2005 *Company Law*, and as discussed later, has continued to serve as a conduit for state intervention in the management of listed companies. Various efforts have, however, been made in the new *Company Law* and subsequent regulatory reforms to improve the effectiveness and accountability of corporate managers, including the Chairman. As the discussion below will suggest, many of the market-oriented changes are not unfamiliar to scholars acquainted with the Anglo-American style of corporate governance.

First, some changes have been made in the new *Company Law* to reinforce the role of the board of directors in executive decision-making. Under the 1993 *Company Law*, it was impossible for the board to meet and pass resolutions, where the Chairman had neither convened a board meeting nor designated the Deputy Chairman or another director to do so.¹³ The new *Company Law* makes it clear where the Chairman fails to do either, such responsibility may be performed by the Deputy Chairman, or a director nominated by more than half of directors.¹⁴ Furthermore, the new *Company Law* gives the power to requisition interim board meetings to a much wider range of corporate actors, including shareholders who hold at least 10 per cent of company shares.¹⁵ To ensure the equal decision-making power of all directors, the new *Company Law* also specifies the principle of one director one vote over board resolutions.¹⁶ As another effort to strengthen the role of the board, the new *Company Law* broadly endorses the system of independent directors previously introduced by the China Securities Regulatory Commission (CSRC) for listed companies, and designates the State Council to make more detailed rules in the area.¹⁷

¹³ 2005 PRC *Company Law* art 114.

¹⁴ Ibid art 110(2).

¹⁵ Ibid art 111(2).

¹⁶ Ibid art 112(2).

¹⁷ 2005 PRC *Company Law* art 123. The new *Company Law*'s deferral of its regulatory power in this area to the State Council has disappointed many of the system's strong proponents, including the China Securities Regulatory Commission (the 'CSRC') who first introduced the system to listed companies in 2001. According to An Jian, given the lack of evidence for the effectiveness of the system at least prior to the 2005 *Company Law* reform (as discussed in Chapter 5), this broadly-drafted provision might serve as a practical solution. It at least leaves sufficient room for the CSRC to carry out further reforms in the area. See 安健 [An Jian], above n 3, 13.

Second, as a corollary to strengthening the role of the board of directors, the powers of the Chairman in corporate decision-making have been curtailed. For example, the old Article 120 (1) that granted the board the power to delegate part of its functions to the Chairman has been deleted.¹⁸ As discussed in Chapter 5, the close involvement of the Chairman in the day-to-day operations of the company was also associated with his or her role as the company's statutory legal representative. The revised *Company Law* allows companies to appoint their legal representatives from a much broader range of senior executives including the Chairman, executive directors and the General Manager.¹⁹ Consequently, the old provision that granted the Chairman the power to sign the shares and bonds of the company has also been removed.²⁰

Third, the new *Company Law* has expanded the powers of the supervisory board in monitoring directors. Hence, in addition to their routine powers to inspect company financial affairs and audit directors' meetings, the supervisory board is given the right to make enquiries and suggestions at the meetings of board of directors.²¹ The revised *Company Law* also grants the supervisory board the power to investigate any irregularities in company operations.²² In so doing, it may seek help from professional advisors such as accountants, with expenses covered by the company.²³ Further, under the 2005 *Company Law*, where a director or senior manager fails to rectify an alleged wrongdoing upon request, the supervisory board has more options at its disposal. It may convene and preside over an extraordinary general meeting to report its findings to the shareholders,²⁴ or propose the general meeting to remove the wrongdoer.²⁵ At the request of shareholder(s) with at least one per cent of shareholding in the company for 180 consecutive days, the supervisory board may also bring a derivative action against the wrongdoer to protect the interests of the company.²⁶

¹⁸ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993 ('1993 PRC Company Law'), art 120(1).

¹⁹ 2005 PRC Company Law art 13.

²⁰ 1993 PRC Company Law art 114(3).

²¹ 2005 PRC Company Law art 55(1).

²² Ibid art 55(2).

²³ Ibid.

²⁴ Ibid arts 119(1) and 54.

²⁵ Ibid.

²⁶ Ibid 152(1).

Fourth, further to strengthening the roles of the board of directors and the board of supervisors in corporate governance, the 2005 *Company Law* has sought to enhance the accountability of directors, supervisors and other senior managers by imposing more stringent duties on these persons. The 1993 *Company Law* required directors, supervisors and the General Manager to 'perform their functions and responsibilities loyally' but omitted a directors' duty of care and diligence.²⁷ This very weak regime of directors' duties has been considered by some Chinese legislators as contributing to the problem of insider control in listed companies.²⁸ Under a new Chapter entitled 'qualifications and duties of directors, supervisors and senior managers',²⁹ the revised *Company Law* specifically subjects directors, supervisors, and senior managers to the duty of care and diligence, as well as the duty of loyalty.³⁰ The new *Company Law* also expands the types of conduct that could constitute a breach of directors' duty of loyalty. Thus, various conflict of interest situations in Anglo-American jurisdictions, from usurping corporate opportunity to accepting secret commissions, have been included.³¹ As will be discussed in Chapter 7, this revamped regime of directors' duties has been further reinforced by the introduction of a number of Anglo-American style shareholders' rights and remedies contained in the new *Company Law*.

Some other checks and balances have also been introduced by the 2005 *Securities Law*. These include additional duties imposed on directors. For example, Article 68 of the new *Securities Law* requires directors, supervisors and senior managers of listed companies to issue their written opinions on company periodical reports and guarantee the truthfulness, accuracy, and completeness of any information disclosed by their companies.³² Article 67 extends the definition of 'major events' that are subject to continuous disclosure by listed companies to include pending judicial investigation into company crimes.³³

²⁷ 1993 PRC *Company Law* art 59.

²⁸ 安健 [An Jian], above n 3, 13.

²⁹ 2005 PRC *Company Law* ch 6.

³⁰ Ibid art 148(1).

³¹ Ibid art 149. Several other provisions of the 2005 PRC *Company Law* also help to contain managerial misbehaviour. For example, Article 116 prohibits companies from lending money to any of its directors, supervisors or senior managers either directly or indirectly. Article 117 requires joint stock companies to regularly disclose to their shareholders information about remuneration received by their directors, supervisors and managers.

³² 2005 PRC *Securities Law* art 68.

³³ Ibid art 67.

Needless to say, the passage of the 2005 *Company Law* and the *Securities Law* has generated another round of administrative rule-making by CSRC and SASAC. While some of these new rules mainly concern the implementation of legislative changes,³⁴ others have introduced further reforms to modernise Chinese corporate governance. One reform that has played an important role in aligning Chinese corporate governance with international best practices is the introduction of the *Basic Standards for Enterprise Internal Control* (the *Basic Standards*).³⁵ This document has been referred to as the 'Chinese version of the *Sarbanes-Oxley Act*'.³⁶ This is because it requires all companies listed in China to establish, by July 2009, an internal control system in line with the framework adopted in the US *Sarbanes-Oxley Act*. Listed companies are further required to undertake self-evaluation of their internal controls, publish annual self-evaluation reports and appoint accounting firms to audit and report on the effectiveness of their internal controls.³⁷

Moreover, to provide directors and managers with greater incentives to maximise the financial performance of their companies, the CSRC has allowed listed companies that satisfy prescribed conditions to adopt equity-based incentive plans to reward their directors and managers.³⁸ The 2005 'split share structure reform' has made the implementation of these plans possible. As noted in Chapter 4, the reform has so far had limited impact on the concentrated shareholding structure in Chinese listed companies.

³⁴ For example, 《上市公司章程指引》 [Guidelines on Article of Association of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 16 March 2006, 《上市公司股东大会规则》 [Rules on General Meeting of Listing Companies] (People's Republic of China) China Securities Regulatory Commission, 16 March, 2006. These guidelines and rules brought relevant regulations and guidelines previously issued by the CSRC in line with the 2005 Company Law and the 2005 Securities Law.

³⁵ 《企业内部控制制度基本规范》 [Basic Standards for Enterprise Internal Control] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 22 May 2008 ('Basic Standards'). Three sets of supplementary guidelines were further issued in 2010 to assist the implementation of the *Basic Standards*. The three sets of guidelines are Enterprise Internal Control Application Guidelines No.1 to No.18, the Enterprise Internal Control Assessment Guidelines and Enterprise Internal Control Auditing Guidelines.

³⁶ Xianchu Zhang, 'Company Law Reform in China' in John Garrick (ed), *Law and Policy for China's Market Socialism* (Routledge, 2012) 39, 46

³⁷ 《关于印发〈企业内部控制基本规范〉的通知》 [Circular on Release of the Basic Standards for Enterprise Internal Control] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 22 May 2008; *Basic Standards* art 10.

³⁸ 《上市公司股权激励管理办法 (试行)》 [Measures for the Administration of Equity Incentive Plans of Listed Companies (For Trial Implementation)] (People's Republic of China) China Securities Regulatory Commission, 31 December 2005; 《国有控股上市公司 (境外) 实施股权激励试行办法》 [Trial Measures for the Implementation of Equity Incentive Plans by State-controlled Companies Listed Overseas] (People's Republic of China) State-owned Assets Supervision and Administration, 27 January 2006; 《国有控股上市公司 (境内) 实施股权激励试行办法》 [Trial Measures for the Implementation of Equity Incentive Plans by Domestically Listed State-controlled Companies] State-owned Assets Supervision and Administration Commission and Ministry of Finance, 30 September 2006.

However, the unification of previous non-tradeable state (and state legal person) shares with tradeable shares through the reform paved the way for the utilisation of stock market-based mechanisms, including equity-based director incentive plans, to improve corporate governance in listed companies.

This section has so far reviewed China's post-2005 legal and regulatory reforms of state-manager relations within listed SOEs. The effectiveness of these various market-based changes would depend on ongoing development of the stock market and the rule of law in China. However, by exposing listed SOEs and their managers to the concepts and principles of corporate governance in developed market economies, these reform measures, at least in theory, would not only help to mitigate the problem of insider control within these companies, but also make them 'better equipped to compete and develop in an increasingly globalised economy'.³⁹ Nevertheless, to characterise China's post-2005 regulation of state-manager relations concerning listed SOEs, these changes at the level of listed companies must be viewed together with those at the parent SOE level.

6.3.2 Regulatory changes to state-manager relations in parent SOEs

China's post-2005 reforms of corporate governance in parent SOEs have been associated with the emergence of SASAC as a state-owned assets regulator and state shareholder in over 100 central SOEs. Wholly owned by the central government, these gigantic enterprises control more than 300, typically largest, listed companies in China.

As noted in Chapter 2, as China's new generation of leaders came to power in late 2013, a new round of SOE reform has been launched. The tasks of reform outlined by the Party at the Third Plenum of the 18th Party Congress include the following: to encourage mixed-ownership in wholly state-owned enterprises by introducing private investments, to strengthen corporate governance through promoting professional management, and to further reform the system for managing state-owned assets through, among other means, defining the functions of individual SOEs (and setting performance targets accordingly) and establishing a number of state-owned capital operating companies to hold state shares in central SOEs.⁴⁰ More detailed plans to carry out these reform tasks are yet to be released. However, as the discussion below will

³⁹ Wang and Huang, above n 8, 239.

⁴⁰ 《中共中央关于全面深化改革若干重大问题的决定》 [Decision on Several Major Issues Concerning Comprehensively Deepening Reforms], adopted at the Third Plenum of the 18th Central Committee of the Chinese Communist Party, 12 November 2013 ('*Decision on Deepening Reforms*').

suggest, some of these market-oriented strategies have been set in place by SASAC over the past few years.

Two major initiatives have underlined SASAC's efforts to turn central SOEs from traditional enterprises into modern large corporations. These are the 'standardised board' reform and the promotion of full listing of central SOEs on domestic and international stock markets. Although both reforms only concern central SOEs controlled by SASAC, they may be expected to have been replicated, or adapted to various extents, at the local levels. This is because as the national state-owned assets management authority, SASAC is also charged with guiding and supervising the work of local SASACs.⁴¹

Before the creation of SASAC in 2003, governance reform at the level of central SOEs lagged behind their listed subsidiaries. Notwithstanding the passage of the first PRC *Company Law* in 1993, most central SOEs remained registered under the 1988 *Law on Industrial Enterprises Owned by the Whole People*.⁴² The governance system prescribed by that piece of legislation is the 'factory top manager responsibility system', that is, a single executive in control.⁴³

This one-man-in-control system also had strong influence on the central SOEs that have been converted into wholly state-owned companies, and registered under the 1993 *Company Law*. This was despite the mandate for a board structure by the latter. Given the high level of comingling between senior executives in central SOEs and their listed subsidiaries, this one-man-in-control model also exacerbated the problem of insider control within listed SOEs. The substantial risks associated with this model were manifested in several major corporate scandals involving central SOEs and their listed subsidiaries. These included the 2004 China Aviation Oil saga which led to the collapse of a Singapore-listed subsidiary.⁴⁴ In another case, a former Chairman of Sinopec was

⁴¹ 《企业国有资产监督管理暂行条例》 [Interim Regulations on the Supervision and Administration of Enterprise State-owned Assets] (People's Republic of China) State Council, 13 May 2003, art 13.

⁴² 《全民所有制工业企业法》 [Law on Industrial Enterprises Owned by the Whole People] (People's Republic of China) National People's Congress, 13 April 1988

⁴³ Ibid art 7.

⁴⁴ 'Costly Lessons from the CAO Scandal', *China Daily* (online) (23 December 2004) <http://www.chinadaily.com.cn/english/doc/2004-12/23/content_402605.htm>.

sentenced to a suspended death penalty, for taking bribes of RMB196 million (approximately AUD32 million).⁴⁵

SASAC has undertaken the important step of introducing the so-called 'standardised board' reform, in an effort to strengthen the board effectiveness in central SOEs. It initiated a pilot program in June 2004,⁴⁶ and selected seven central SOEs to participate in the experiment of the 'standardised board'.⁴⁷ By the end of 2011, 42 of the then 121 SASAC-controlled SOEs had undergone this reform.⁴⁸

At the heart of the 'standardised board' is the introduction of SASAC-nominated external directors onto central SOEs' boards of directors. The standardised board has seven to 13 directors with the majority being external directors.⁴⁹ SASAC has also set out detailed rules concerning the desirable mixture of skills among the external directors. For example, the majority of outside directors should have experience in managing large enterprises, and at least one of them should have a background in accounting. The inclusion of foreign external directors is also stressed for companies with substantial business operations overseas.⁵⁰ Furthermore, the standardised board should establish several sub-board committees, including the nomination committee, the remuneration and evaluation committee and the audit committee, to act as advisory bodies to the board.⁵¹ While the majority of the nomination committee are required to be filled by external directors, the latter two committees shall only be filled by external directors.⁵²

⁴⁵ 'Busting the Bribe Tribe', *China Daily* (online) (20 August 2009) <http://www.chinadaily.com.cn/business/2009-08/20/content_8594794.htm>.

⁴⁶ 《关于中央企业建立和完善国有独资公司董事会试点工作的通知》 [Notice on Experimenting the Establishment and Improving the System of Board of Directors in Wholly State-owned Enterprises] (People's Republic of China) State Assets Supervision and Administration Commission, 7 June 2004.

⁴⁷ The seven SASAC-controlled SOEs are Chengtong Group Corporation, Shenhua Group, Baosteel Group Corporation, New Technology Investment Group Corporation, China Pharmaceutical Group Corporation, China International Tourism Service Group Corporation and Railway Communications Group Corporation.

⁴⁸ '国资委再推央企整体上市, 已上市央企融资超 9000 亿' [SASAC Continues to Promote the Full Listing of Central SOEs, Funds Raised by Listed Central SOEs Exceeded RMB900 Billion], *China Venture* (online), 18 May, 2012 <<http://news.chinaventure.com.cn/2/20120518/86119.shtml>>.

⁴⁹ 《董事会试点中央企业董事会规范运作暂行办法》 [Interim Measures for the Standard Operation of the Board of Directors of Central State-owned Enterprises under the Pilot Program on Board of Directors] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 20 March 2009, art 22.

⁵⁰ *Ibid* art 26.

⁵¹ *Ibid* art 28.

⁵² *Ibid* art 29.

To reduce the concentration of management powers within central SOEs, SASAC has also required the standardised board to display a clear separation between the role of the Chairman and that of the General Manager, and a separation of the role of the board from managers involved in the company's day-to-day operations. The Chairman must be responsible for the oversight of the proper functioning of the board, and the General Manager for the organisation of company's day-to-day business operations. The two positions are required to be separated where possible. Central SOEs are further encouraged to appoint their Chairmen from external directors and to appoint legal representatives from General Managers. To separate the role of the board from senior managers, managers other than the General Manager (such as the deputy General Manager and Chief Accountant) should not be assumed by directors.⁵³ A standardised board structure, the Baosteel Corporation board, which was the first central SOE to have completed the reform, is at Appendix 6-1.

To further empower the standardised board, SASAC has begun to delegate central SOEs that have undergone the board reform the power to appoint, evaluate and remunerate some of their senior management positions, including the General Manager, the Chief Accountant and the board secretary.⁵⁴ In relation to wholly state-owned companies, the power to appoint persons to those positions had been conferred on the board of directors by the 1993 *Company Law*.⁵⁵ However, as will be explained in section 6.4, prior to the standardised board reform, these powers were exercised by SASAC (and the Party through the Party's Organisational Department).

At the same time, SASAC has paid considerable attention to improving managerial incentives through introducing performance evaluation of SOE managers, and strengthening managerial responsibility for preserving enterprise assets. Under the new schemes, senior executives, including the Chairman, are required to enter into three-year performance contracts with SASAC. The contracts outline both annual and three-year targets. Profits-based performance indicators, such as annual profits and return on

⁵³ Ibid art 23.

⁵⁴ 《关于董事会试点中央企业董事会选聘高级管理人员工作的指导意见》[Guiding Opinion on Recruiting and Appointment of Senior Managers for State-owned Enterprises under the Pilot Program of Establishing Standardised Board of Directors] (People's Republic of China) Assets Supervision and Administration Commission, 10 October 2008; 《董事会试点中央企业高级管理人员经营业绩考核工作指导意见》[Guiding Opinion on Evaluating the Operational Performance of Senior Managers in Central Government-affiliated SOEs under the Pilot Program on Board of Directors] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 10 October 2008.

⁵⁵ 1993 PRC *Company Law* art 69.

equity, are the key components. In its evaluation of SOE executives at the end of each year and the three-year period, SASAC scores the performance of each executive on a 100-point scale and assigns a grade from A-E accordingly. The grades received by the executives are also tied to their incentive pay.⁵⁶ Further, to strengthen managers' responsibility for preserving state assets vested in their enterprises, SASAC released the *Interim Measures for Pursuing Liability for Loss of Assets to Central Government-affiliated SOEs* in 2008.⁵⁷ The *Interim Measures* specify various administrative penalties that may be imposed on SOE managers, where they have neglected their duties thereby causing a loss of enterprise assets. Such penalties range from fines, dismissal to disqualification from managing an enterprise for a specific period or permanent disqualification.⁵⁸

In addition to strengthening the effectiveness and accountability of SOE boards, another even bolder step taken by SASAC has been the promotion of full listing of central SOEs on domestic and international stock markets.⁵⁹ By the end of 2011, 40 central SOEs had listed the whole, or substantially the whole, of their main business on Chinese mainland and overseas stock markets, primarily, Hong Kong.⁶⁰ However, few of these corporate groups have realised the full listing of their parent central SOEs.⁶¹

SASAC previously set the target to achieve the 'full marketisation' of central SOEs within 10 to 15 years.⁶² This target apparently needs adjustment in light of the Party's

⁵⁶ 《中央企业负责人经营业绩考核暂行办法》 [Interim Measures on the Evaluation of Operational Performance of Top Executives in Central Government-affiliated SOEs] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 30 December 2006.

⁵⁷ 《中央企业资产损失责任追究暂行办法》 [Interim Measures for Pursuing Liability for Loss of Assets to Central Government-affiliated SOEs] (People's Republic of China) State Assets Supervision and Administration Commission, 18 August 2008.

⁵⁸ Ibid art 32.

⁵⁹ 《关于推进国有资本调整和国有企业重组的指导意见》 [Guiding Opinion on Promoting the Adjustment of State-owned Capital and Restructuring State-owned Enterprises] (People's Republic of China) State Council, 5 December 2006. This document provides the policy basis for SASAC's promotion of full listing of central SOEs. This document, for the first time, encouraged SOEs to list their assets or, at least, their core business as a whole on the stock market. For SOEs that have listed subsidiaries, the document suggests that the listed subsidiaries should gradually absorb the remaining business within their respective corporate groups.

⁶⁰ '国资委再推央企整体上市, 已上市央企融资超 9000 亿' [SASAC Continues to Promote the Full Listing of Central SOEs, Funds Raised by Listed Central SOEs Exceeded RMB900 Billion], above n 48.

⁶¹ Two main factors have contributed to the slow process in full listing of central SOEs. First, many of these parent SOEs have some non-performing assets or welfare functions that are difficult to be incorporated into the listed companies. This is despite that to improve the efficiency of central SOEs, SASAC has, since its establishment in 2003, helped these enterprises to divest from their non-core businesses and social welfare functions. Second, the full listing plans have to be devised and implemented by parent SOEs who naturally have a strong disincentive to go full listing by allowing themselves to be integrated into their listed subsidiaries.

⁶² '国资委副主任邵宁: 鼓励国企整体上市' [SASAC Deputy Director Shao Ning: Encourage State-owned Enterprises to Go Full Listing], *China News Net News Story* (8 November 2010) <<http://www.chinanews.com/cj/2010/11-08/2641634.shtml>>.

new vision for the SOE reform. At the Third Plenum of the 18th Party Congress, the Party called for classification of SOEs in accordance with their main business (and setting supervision guidelines accordingly). This means that while the majority of central SOEs (especially profit-seeking companies) would be transformed into listed companies with multiple shareholders, some would remain unlisted with relatively few shareholders (such as those in natural monopoly sectors) or even wholly state-owned (such as those vital to 'national security').⁶³

It seems that SASAC has adopted the strategy of full listing of central SOEs with the Singaporean Temasek model in mind.⁶⁴ If successful, this strategy could turn SASAC (or its investment arm) from an owner-manager of SOEs into a state financial holding agency, similar to Temasek which holds major shareholding in large listed companies. This is also in line with the Party's new vision to transform the management of state-owned assets into a system that focuses on the management of state capital rather than individual enterprises.⁶⁵ There seems to be no legal obstacle for SASAC to hold shares directly in listed central SOEs. This solution, however, requires that the overlapping roles of SASAC as a state shareholder and a regulator of state-owned assets be first addressed. Given the large number of central SOEs, the Party has suggested that a number of state capital operating companies/state investment companies be established (or through re-organisation of some parent central SOEs) under SASAC to hold state shares in listed central SOEs.⁶⁶ It should be noted that this idea is not entirely new in China. Many of these companies have been set up at provincial and municipal levels as part of the state-owned assets management system reform since late 2002 (As chapter 2 explained). Should this strategy proceed at the national level, there is the prospect that some listed central SOEs will become 'parentless' companies indirectly controlled by SASAC through state investment companies in the not-too-far-future.

SASAC and other commentators have identified several advantages for the full listing of central SOEs. First, the integration of the main business of a corporate group into a listed group company will help the latter to achieve greater economies of scale and

⁶³ The detailed classification of central SOEs according to their functions is yet to be released by SASAC.

⁶⁴ '国资委达共识拟直接持股央企' [Consensus Reached within SASAC on its Direct Shareholding in Central SOEs] *Xinhua Net News Story* (12 June 2011) <http://news.xinhuanet.com/finance/2011-06/12/c_121523643_3.htm>.

⁶⁵ *Decision on Deepening Reforms*, above n 40.

⁶⁶ '国资委直接持股上市公司明年或破题' [Possible Breakthrough on SASAC Direct Shareholding in Listed Companies in Coming Year], *China Net News Story*, 7 December 2012 <http://www.china.com.cn/policy/txt/2012-07/12/content_25885656.htm>.

synergies in business operations. As the capacity of these companies expands, their international competitiveness may also be enhanced. Second, an overall listing would lead to better liquidity of state-owned assets, thereby providing SASAC with greater flexibility in the management of state-owned assets.⁶⁷

Corporate governance, nevertheless, plays a dominant role. This is particularly so as SASAC has combined full listing with listing SOEs on overseas, especially the Hong Kong stock markets. SASAC acknowledged that the practice of partial listing had contributed little to improving the governance of central SOEs. This is because the listed subsidiary usually only constitutes a small part of a much larger corporate group. Therefore, through subjecting the operation of parent SOEs to the discipline of domestic and overseas stock market, full listing will help to enhance the overall governance of central SOEs.⁶⁸

The above review of China's post-2005 reforms concerning state-manager relations within listed SOEs and their parent companies showed that, in an effort to solve the governance problems of these companies, including the problem of insider control, Chinese policy makers have become far more receptive to Western principles and structures of corporate governance. Consequently, many governance mechanisms of the Anglo-American advanced market economies have been introduced into Chinese companies. As this section has demonstrated, while some of these mechanisms place more checks and balances on the exercise of powers by top corporate executives, others provide directors with stronger incentives to maximise company financial performance. Indeed, as Naughton argued, the performance-based remuneration of central SOE executives may have contributed to the impressive profit records of these enterprises over the past few years.⁶⁹ Still other efforts have been adopted to enlist market-based institutions, such as external directors, outside investors, and foreign stock market regulators to monitor and discipline managers. In this respect, the prospect of establishing a number of state-owned capital operating companies will no doubt lead state-manager relations in listed central SOEs to further shift away from the traditional state-led model which mainly relied upon administrative control and supervision.

⁶⁷ '国资委副主任邵宁：鼓励国企整体上市' [SASAC Deputy Director Shao Ning: Encourage State-owned Enterprises to Go Full Listing], above n 62.

⁶⁸ Ibid.

⁶⁹ Barry Naughton, 'China's Distinctive System: Can it be a Model for Others?' 2010 (19) *Journal of Contemporary China* 437, 453.

However, to assess whether this shift would cause a greater convergence of these relations towards the Anglo-American model, the various continuities in China's post-2005 regulation of state-manager relations need examination. As the discussion below will suggest, state involvement in the affairs of listed SOEs is likely to continue, despite various market-oriented reforms as discussed above.

6.4 Post-2005 regulation of state-manager relations: what has not changed?

First, the promotion of mixed ownership in central SOEs by new Chinese leaders is unlikely to alter ultimate state control of large and strategic listed SOEs. As discussed in Chapter 2, one of the main objectives for the Chinese SOE reform, as stressed by successive Chinese leaders, is to 'consolidate and develop the public sector' to 'enhance its vitality' and 'capacity to leverage and influence the economy'.⁷⁰ As long as the state retains a major shareholding in listed SOEs, state involvement in corporate affairs is likely to be inevitable. Indeed, this point has been shown by Milhaupt and Pistor in their analysis of the role of the Singaporean government in the aftermath of the CAO scandal.⁷¹

Second, in addition to ownership links, the ultimate control of the Party/government over key personnel appointments in central SOEs has not changed, and is not likely to change with the full listing of central SOEs. As noted in Chapter 5, the system of 'Party management of cadres'⁷² has remained a fundamental instrument for the Party-state to retain control over these large companies. Among the 121 SASAC-administrated central SOEs by the end of 2011, the top three leadership positions, namely, the Chairman, the Party Secretary and the General Manager, in 53 of the largest ones were, and remain, appointed and evaluated by the Organisational Department of the Central Party Committee. For the remaining 68 central SOEs, as noted earlier, SASAC has authorised those that had undergone the standardised board reform to appoint some of their senior management roles such as the General Manager and the Deputy General Manager. SASAC, however, retains the power over the appointment, evaluation and

⁷⁰ *Decision on Deepening Reforms*, above n 40; Full text of Hu Jintao's Report at the 18th Congress of the Chinese Communist Party (17 November 2012) <http://news.xinhuanet.com/english/special/18cpcnc/2012-11/17/c_131981259.htm>.

⁷¹ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) 146.

⁷² For a detailed illustration of the system, see John Burns (ed), *The Chinese Communist Party's Nomenklatura System* (M.E. Sharp, 1989) 4.

remuneration of the top two leadership positions in these enterprises, namely, the Chairman and the Party Secretary.⁷³ Moreover, SASAC also appoints, evaluates and decides the remuneration of other directors, including external directors, and supervisors in these large companies.⁷⁴ Personnel decisions in local SOEs at provincial, municipal and county levels are managed by the local branches of the Organisational Department of the Party Central Committee and local SASACs.⁷⁵

The system of 'Party management of cadres' has operated in a similar fashion in listed SOEs in the financial sector. Indeed, most of the Huijin-controlled companies, including China's largest four commercial banks, have achieved full listing of parent SOEs. Yet the executive directors of these companies, such as the Chairman and the Bank President, remain appointed by the Party's Organisational Department, while most of the non-executive directors (except independent directors) in these companies are nominated by Huijin.⁷⁶ Although the new Chinese leadership has called for 'increasing the proportion of market-oriented recruitment' as a means to promoting professional management in SOEs,⁷⁷ it has expressed no intention to relinquish Party/government control over the appointment of key personnel, including the Chairmen, in large and strategic SOEs. As long as this power is to be retained by the Party, corporate executives are likely to be 'incentivised' to adhere to the policy goals of the Party and government.⁷⁸

Second, whether SASAC is to remain the state shareholder in central SOEs, as a state assets regulator, its extensive administrative powers over these companies are unlikely to be curtailed.⁷⁹ These include the power to approve central SOEs' investments that fall outside their respective core businesses which are defined by SASAC. Indeed, the

⁷³ 丘静、刘已洋 [Qiu Jing and Liu Siyang], 《中国国有控股上市公司的治理结构和董事会的作用》 [Corporate Governance Structure and the role of the Board of Directors in State-controlled Listed Companies in China] (China Seri Economic Research Institute, April 2011) 12 <www.serichina.org>; Andrew Szamosszegi and Cole Kyle, 'An Analysis of State-owned Enterprises and State Capitalism in China' (U.S. -China Economic and Security Review Commission, 26 October 2011) 75 <<http://www.uscc.gov/Research/analysis-state-owned-enterprises-and-state-capitalism-china>>. The total number of central SOEs had been reduced to 116 by the end of 2013 through mergers among Central SOEs.

⁷⁴ 《中华人民共和国企业国有资产法》 [Law of the People's Republic of China on Enterprise State-owned Assets] National People's Congress Standing Committee, 28 October 2008, art 22(2).

⁷⁵ Szamosszegi and Kyle, above n 73.

⁷⁶ The 2011 Annual Reports of relevant listed companies.

⁷⁷ *Decision on Deepening Reforms*, above n 40.

⁷⁸ Szamosszegi and Kyle, above n 73, 48, 77.

⁷⁹ For SASAC powers as the central government state-owned assets regulator, see 《中华人民共和国企业国有资产法》 [Law on Enterprise State-owned Assets of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 28 October 2008.

central government has conferred on SASAC broad powers to administer outbound foreign direct investment by central SOEs, in an effort to strengthen the supervision of the implementation of China's 'go global' strategy.⁸⁰ Hence, under the *Interim Measures for Supervision and Administration of Foreign Investment by Central Enterprises* (the *Interim Measures*) released by SASAC in March 2012,⁸¹ SASAC is responsible for overseeing the establishment of an internal foreign investment management system within all central SOEs, and the preparation of annual investment plans by these enterprises.⁸² Foreign investment projects that fall under a central SOE's core business (as defined by SASAC) must be included in its annual investment plans and lodged with SASAC for record keeping.⁸³ Projects that fall outside the core business must be submitted to SASAC for approval.⁸⁴ The boards of central SOEs are also required to be responsible to SASAC, implement SASAC decisions, accept its guidance and maintain transparency in board operations to SASAC.⁸⁵

Third, as long as SASAC remains the ultimate controller of listed central SOEs, channels for SASAC to be involved in the management of these companies (directly or, indirectly through the state assets operating companies) remain available under the 2005 *Company Law*. The principle of general meeting supremacy has been preserved by the *New Company Law*, which means the general meeting remains a company's supreme organ of authority with a broad range of management powers.⁸⁶ This is despite the new *Company Law* allowing companies to allocate other powers not specified in the *Company Law*, such as the power to appoint auditors, between the general meeting and the board of directors through company constitution.⁸⁷ Furthermore, despite the wide ranging market-oriented changes, the presence of the Party in Chinese companies has been retained and even strengthened. The 1993 *Company Law*, echoing a relevant

⁸⁰ Other central government agencies, such as the Ministry of Commerce and National Reform and Development Commission are also involved in the regulation of outbound direct investment by Chinese enterprises.

⁸¹ 《中央企业境外投资监督管理暂行办法》 [Interim Measures for the Supervision and Administration of Overseas Investments by Central Government-affiliated SOEs] (People's Republic of China) State-owned Assets Supervision and Administration Commission, Order No 28, 13 August 2012.

⁸² Ibid art 8.

⁸³ Ibid art 6.

⁸⁴ Ibid art 10.

⁸⁵ Ibid art 30.

⁸⁶ This addition is, however, unlikely to alter the current power structure that exists within most state-controlled companies. This is especially so given that the modification of constitution requires at least two thirds votes cast by shareholders participating in the voting. See 2005 PRC *Company Law* art 104 (2)

⁸⁷ 2005 PRC *Company Law* arts 100 and 38(1).

provision in the Constitution of the Party,⁸⁸ provided that a grassroots organisation of the Party shall be established in all companies to carry out its activities according to the Party's Constitution.⁸⁹ Article 19 of the new *Company Law* retains this provision, and goes further to require that 'companies shall provide necessary conditions to assist the activities of the Chinese Communist Party'.⁹⁰ This addition followed the release of a joint circular issued by the Organisational Department of the Central Party Committee and SASAC in 2004,⁹¹ which called for establishing the Party's 'core political' status in central SOEs.⁹²

6.5 Conclusion

This chapter has reviewed China's post-2005 developments in the regulation of state-manager relations in large state-controlled listed companies. Through examining the changes and continuities thereof, this chapter has shown the emergence of a new state-led approach to the regulation of those relations. On the one hand, this approach has significantly moved away from the pre-2005 state-led model by applying extensive market-based governance mechanisms to both listed companies and their state-owned parents. On the other hand, viewed in conjunction with the various non-marked based changes and substantial continuities in China's post-2005 regulatory framework, the various market-based mechanisms that have been, or will be, introduced are likely to strengthen, rather than weaken, the effectiveness of Party-government's control over these large entities.

As this chapter also discussed, further steps along the road of market-oriented reforms have been pledged by the Party under its new leadership. However, as the Party has expressed no intention to withdraw the state from large and strategic SOEs, a similar

⁸⁸ 《中国共产党党章》 [The Constitution of the Communist Party of China], art 29. According to the Constitution of the Chinese Communist Party, a grass-root Party organisation shall be established in any organisation that has at least three full Party members.

⁸⁹ 2005 PRC *Company Law* art 17.

⁹⁰ *Ibid* art 19.

⁹¹ 《关于加强和改进中央企业党建工作的意见》 [Opinion on Strengthening and Improving Party Building Work in Central Government-affiliated SOEs] (People's Republic of China) The Organisational Department of the Central Party Committee and the Party Committee of the State-owned Assets Supervision and Administration Commission, 31 October 2004.

⁹² *Ibid*. According to this document, the grassroots Party Committee shall play two main roles in state-controlled listed companies. The first is to ensure the implementation of the Party and the state's principles and policies within their respective companies. Secondly, the Party Committee must participate in company major decision-making. The long list of decisions that fall under this category include enterprise development strategies, medium to long term development plans, enterprise production and operational guidelines, annual budget and final accounts, major issues in enterprise restructuring and capital operation, the drafting or revision of major enterprise reform plans and management systems, major personnel arrangements and major issues related to the interests of the employees.

purpose is likely to be served by these new reform strategies. This approach clearly contradicts the popular prediction in the current literature (as discussed in Chapter 2) that Chinese corporate governance, is, or should be, gradually converging with the Anglo-American outsider-based model.

How might we interpret these changes and continuities from the perspective of state-capitalism and institutional change? Before addressing this question, Chapter 7 examines China's post-2005 legal and regulatory reforms of two other sets of company relations central to the former state-led governance model, namely, investor and other stakeholder (including employee) protection. The examination of the changes, and continuities, in the regulation of these latter two sets of relations will help to illuminate the model of corporate governance that has emerged in China since the 2005 corporate law reforms.

CHAPTER 7 CHANGES AND CONTINUITIES IN CHINA'S POST-2005 REGULATION OF INVESTOR AND OTHER STAKEHOLDER PROTECTION

7.1 Introduction

Through examining China's post-2005 reforms of state-manager relations in listed state-owned enterprises (SOEs), Chapter 6 illustrated the emergence of a new state-led approach to the regulation of that set of company relations. While various channels for state involvement in corporate decision-making remain in place, many mechanisms of the Anglo-American outsider-based corporate governance have been applied to strengthen monitoring of managers.

Interpreting corporate governance in Chinese listed SOEs today also requires an examination of China's post-2005 regulation of investor and other stakeholder protection within these large entities. As discussed in Chapter 3, although these two sets of company relations often receive separate treatment in Anglo-American studies of corporate governance, this does not need to be the case. In the former post-war state-led model, both minority shareholders and other non-shareholder stakeholders (with the notable exception of employees) were treated as company outsiders, with their interests in the companies largely marginalised or suppressed. As discussed in Chapter 5, Chinese corporate governance prior to 2005 closely resembled the former state-led model, particularly in relation to minority shareholder and other stakeholder protection. Therefore, in examining China's post-2005 regulation of these two sets of relations in listed SOEs, a combined discussion will help to illuminate the legal and regulatory changes and continuities in both areas.

This chapter will demonstrate the emergence a new state-led approach in China's post-2005 regulation of those two sets of company relations. This approach, which can be called a 'state-led stakeholder' approach, attaches equal importance to the state retaining ultimate control and the coordinative capacity of the state to adjust company relations with their investors and other non-shareholder stakeholders. On the one hand, compared to the narrowly focused former state-led model, this model presents a far more inclusive approach by drawing upon elements from both the Anglo-American outsider-based/shareholder-oriented and the broader stakeholder governance models. On the other hand, as this chapter will illustrate, few of the Chinese post-2005 reforms have led to a transfer of the ultimate control of the state over these two sets of company

relations to non-state sectors, such as individuals and private organisations. Instead, strong state control over shareholder and other stakeholder activism, especially organised activism, has been facilitated by the 'watered down' version of many of the transplanted rules, as well as an ongoing reluctance of the courts to handle securities-related private lawsuits. The latter is particularly the case with shareholder class actions against listed companies (and the state).

This chapter will proceed as follows. Section 7.2 sets the stage by contrasting the former state-led model of corporate governance with the Anglo-American outsider-based/shareholder and the broader stakeholder models from the perspective of investor and non-shareholder stakeholder protection. Section 7.3 discusses the main changes in China's post-2005 regulation of those two sets of company relations. Section 7.4 discusses the continuities. In doing so, relevant provisions of the 2005 *Company Law* and the *Securities Law* and related administrative regulations and guidelines will be examined. By way of conclusion, section 7.5 links these changes and continuities with Chapter 6 to highlight the key features of the state-led stakeholder model of corporate governance that has emerged in China through its post-2005 reforms of corporate governance in listed SOEs.

7.2 Shareholder, stakeholder, and state-led models of corporate governance

The longstanding debate over the relative merits of the shareholder (stockholder) versus stakeholder approach of corporate governance may be traced back to the writings of Professors Berle and Dodd in the 1930s.¹ While the shareholder model that coincides with the Anglo-American outsider-based corporate governance has remained dominant, the broader stakeholder model has gained increasing attention.²

The two approaches differ in both the conceptions of the corporation and the role of corporate governance. Grounded in agency theory of the firm (as outlined in Chapter 2), the shareholder approach sees maximising financial return to individual shareholders as

¹ Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations Report* (2006) 19-20; Adolf Berle, 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049; Adolf Berle, 'For Whom Corporate Managers are Trustees: A note' (1932) 45 *Harvard Law Review* 1365; E.Merrick Dodd, 'For Whom are Corporate Managers Trustees' (1932) 45 *Harvard Law Review* 1145.

² Corporations and Markets Advisory Committee, above n 1, 1.

the only relevant function of a corporation.³ Therefore, corporate managers, as Professor Berle argued, should be held accountable only to the shareholders.⁴ In contrast to this narrowly construed shareholder-oriented view, the stakeholder approach, advocated by Professor Dodd, postulated that corporate managers should be allowed to take into account the interests of the wider community including, but not limited to, shareholders.⁵ This approach is reflected, to various extents, in the insider-based governance systems in large companies in Germany and post-1980s Japan. As discussed in Chapter 2, these systems place greater emphasis on the interests of certain non-shareholder stakeholders, such as employees and banks as creditors, apart from large shareholders. However, the range of interests encompassed in the stakeholder approach is much broader. The notion of corporate social responsibility is therefore closely related to this approach.⁶ The many definitions of corporate social responsibility, according to Ho, converge on two dimensions: (1) how the company conducts its business as a 'good corporate citizen', and (2) the company's responsiveness to its internal and external stakeholders such as shareholders, employees, local communities in which companies operate and the environment.⁷

A number of conceptions about the corporation lend support to the broad stakeholder approach to corporate governance. These include the natural entity theory that draws an analogy between a company and a natural person, and the communitarian theory that sees companies as 'institutions whose conduct can have substantial public implications'.⁸ Nevertheless, as Dodd suggested, the argument for the stakeholder approach is not purely theoretical.⁹ Indeed, in more recent years, increased attention to this approach has been generated by the rapid rise of multinational corporations as

³ Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991); Roman Tomasic, Stephen Bottomley and Rob McQueen, *Corporations Law in Australia second edition* (The Federation Press, 2002) 56-57.

⁴ Berle, 'For Whom Corporate Managers are Trustees: A note', above n 1, 1367.

⁵ Dodd, above n 1, 1162-3. In one stronger version, directors should not only take into consideration, but also be held accountable to those different groups of interests. Margaret M. Blair, 'Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century' in Thomas Clarke (ed), *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* (Routledge, 2004) 174, 174-5.

⁶ Tomasic, Bottomley and McQueen, above n 3, 63-64.

⁷ Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375, 382.

⁸ Tomasic, Bottomley and McQueen, above n 3, 60. Other theories in support of a stakeholder approach to corporate governance include the 'team production' theory of the firm. See Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 *Virginia Law Review* 247.

⁹ Dodd argued that strong support for a stakeholder approach can be found in changing 'attitude of law and public opinion' towards the nature of a business corporation. See Dodd, above n 1, 1163.

predominant social economic actors, and increasing public concerns about the adverse social and environmental impacts of their business operations. These concerns have no doubt been fuelled by campaigns from not-for-profit or non-government organisations, as they seek to influence corporate decision-making with regard to their organisational goals.¹⁰ Against this background, a business case for corporate social responsibility has also been advanced.¹¹ It is argued that companies that excel in corporate social responsibility will also thrive 'as a sustainable business enterprise in society over the long run'.¹² Indeed, as Thomas Clarke observed, corporate executives of major companies in the US and the UK have increasingly adopted certain elements of the stakeholder approach to 'grapple with the need to satisfy the interests of more complex constituencies than shareholder theory would suggest'.¹³

The greater public demand for a broader stakeholder approach to corporate governance has also spurred a remarkable growth in various corporate social responsibility initiatives at both international and national levels.¹⁴ In this area, it is worth noting that, adopting an 'enlightened shareholder value' view,¹⁵ the UK *2006 Companies Act* explicitly requires directors to take into account the interests of a broad range of company stakeholders in fulfilling their duty to promote the success of the company for the shareholders as a whole.¹⁶

From the perspective of shareholder and other stakeholder protection, the former post-war state-led corporate governance may be distinguished from both the shareholder and stakeholder models discussed above. If the state-led model can be viewed as a variant of

¹⁰ Corporations and Markets Advisory Committee, above n 1, 16; David Kinley, Justine Nolan and Natalie Zerial, 'The Politics of Corporate Social Responsibility: Reflections on the United Nations Human Rights Norms for Corporations' (2007) 25 *Company and Securities Law Journal* 30; Justine Nolan, 'With Power comes Responsibility: Human Rights and Corporate Accountability' (2005) 28 *University of New South Wales Law Journal* 581.

¹¹ Corporations and Markets Advisory Committee, above n 1, 40

¹² Bryan Horrigan, *Corporate Social Responsibility in the 21st Century: Debates, Models and Practices Across Government, Law and Business* (Edward Elgar Publishing, 2010) 7; also see Corporations and Markets Advisory Committee, above n 1, 40-47.

¹³ Thomas Clarke, 'The Stakeholder Corporation: a Business Philosophy for the Information Age' in Thomas Clarke (ed), *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* (Routledge, 2004) 189, 197.

¹⁴ At the international level, since the 1970s, international organisations such as United Nations and the OECD have released many guidelines and other policy documents encouraging corporate social responsibility, especially for multinational companies. Various voluntary standards or systems in this respect have also been developed by many non-governmental organisations such as Social Accountability International and International Organisation for Standardization. For a review of these guidelines and standards, See Horrigan, above n 12, 8-19.

¹⁵ Corporations and Markets Advisory Committee, above n 1, 103.

¹⁶ UK *Companies Act 2006* s 172.

the broader stakeholder model, the state is, arguably, the most important stakeholder of all. As discussed in Chapter 3, in the former post-war state-led economies, where state involvement in corporate affairs was prioritised as a means to promote national development goals, the state played a central role in structuring company relations with its internal and external stakeholders through various legal and non-legal means. This led to a distinctive divide between corporate insiders and outsiders. The interests of large shareholders, managers and employees that are important to the implementation of the economic-oriented goals of the state became the targets of state coordination. This was, however, at the expense of outsider investors and other non-employee stakeholders whose short-term demands were not considered as consistent with the long-term goals of the companies and the state.

As Chapter 5 discussed, China's poor performance in shareholder and other stakeholder protection pre-2005 resembled some key features of the former state-led model. While the voice of the outsider shareholders and stakeholders was largely muted, poor protection of minority shareholders was further exacerbated by the overlapping roles of the state as an ultimate corporate controller, a regulator and adjudicator of securities-related disputes. This coincidence of state power with state ownership in Chinese large listed companies has not changed to any significant extent post-2005, and as discussed in section 7.4, has played a major role in constraining shareholder and other stakeholder activism, especially organised activism, in corporate governance. However, as also will be shown, China's post-2005 regulation of these two sets of company relations have moved towards a far more inclusive approach by drawing upon both the shareholder and the broader stakeholder governance models.

7.3 Post-2005 regulation of investor and other stakeholder protection: what has changed?

7.3.1 Investor protection

As noted in Chapter 6, strengthening legal protection of investors was one of the most pronounced legislative objectives for the 2005 amendments to the PRC *Company Law*¹⁷ and *Securities Law*.¹⁸ By drawing upon international experiences, particularly those of Anglo-American jurisdictions, many new provisions have been introduced into these

¹⁷ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005 ('2005 PRC *Company Law*').

¹⁸ 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005 ('2005 PRC *Securities Law*').

two corporate law statutes to address problems faced by minority shareholders under the former framework. As the examination below will suggest, while some of the legislative changes allow minority shareholders greater opportunities to participate in corporate decision-making, others provide them with far better protection from abuse of power by controlling shareholders and other corporate insiders. In addition, an increased focus on strengthening investor confidence has led China's corporate regulators such as the China Securities Regulatory Commission (CSRC) and the State-owned Assets Supervision and Administration Commission (SASAC) to adopt many new initiatives in their relevant areas.

First, enhancing minority shareholder participation in corporate governance has been one of the key changes introduced by the 2005 *Company Law*. The general meeting is the primary forum for shareholders to participate in corporate decision-making. However, as noted in Chapter 5, by vesting all the powers to convene meetings in the board of directors,¹⁹ the 1993 *Company Law* provided shareholder(s) with no such right as to either convene a general meeting or propose a resolution to be passed at general meetings. The new *Company Law* grants shareholders with 10 per cent or more company shares for at least 90 days the power to convene and preside over a general meeting, where both the directors and the board of supervisors have failed to do so.²⁰ Shareholders with three per cent or more company shares may also propose resolutions to be passed at general meetings.²¹

The codification of the system of cumulative voting is another effort made by the new *Company Law* to strengthen minority shareholder participation in corporate governance. Cumulative voting maximises the opportunity for minority shareholders to obtain board representation by allowing shareholders to multiply their votes by the number of directors to be elected and cast all their votes on one or more preferred candidates.²² The system was previously mandated by the CSRC, for the election of directors in listed companies with a more than 30 per cent controlling shareholder.²³ The new *Company*

¹⁹ 2005 PRC *Company Law* art 105(1).

²⁰ Ibid art 102(2).

²¹ Ibid art 103(2).

²² Ibid art 106(2).

²³ 《上市公司治理准则》 [Code of Corporate Governance for Listed Companies in China] (People's Republic of China) China Securities Regulatory Commission and State Economic and Trade Commission, 7 January 2002 ('CSRC Code of Corporate Governance'), art 31.

Law allows all joint stock companies to adopt the system for the election of directors and supervisors through company constitution or resolution of shareholders.²⁴

Moreover, relevant to shareholder participation in corporate governance, their access to company information has been expanded under the new *Company Law*. In relation to joint stock companies, the 2005 *Company Law* entitles shareholders to inspect a broad range of company documents, including general meeting minutes, board resolutions and company financial and accounting reports. Based on their inspection of company documents, shareholders may also question or make recommendations about company operations.²⁵

Further to shareholder participation in corporate governance, the new *Company Law* and *Securities Law* have made some efforts to tackle the abuse of power by controlling shareholders and other corporate insiders. Hence, in addition to a revamped regime of directors' duties as Chapter 6 discussed, the 2005 *Company Law*, in broad terms, imposes a liability on shareholders (essentially the controlling shareholder) to compensate for causing any loss to the company or other shareholders by abusing their rights as shareholders.²⁶

As discussed in Chapter 5, related party transaction was one of the major avenues for parent SOEs to exploit minority shareholders of listed companies. Aspects of the regime of related party transactions have also been strengthened in the revised *Company Law*.²⁷ For example, in response to the widespread practice of provision of guarantees by listed companies in favour of their parent SOEs,²⁸ Article 16 requires the provision of

²⁴ 2005 PRC *Company Law* art 106(1).

²⁵ Ibid art 98. Upon request by the general meeting, directors, supervisors and senior managers must make themselves available at the meeting to address inquiries from shareholders. See 2005 PRC *Company Law* art 151 (1).

²⁶ Ibid art 20(2).

²⁷ The term 'related party transaction' is defined as 'any transactions that involve transfer of benefits or obligations between a listed company or an entity controlled by the listed company and a related party'. See 《上海证券交易所股票上市规则》 [Shanghai Stock Exchange Listing Rules] (People's Republic of China) Shanghai Stock Exchange, first became effective in January 1998, has since undergone several revisions with the most recent taking place on 7 July 2012. Issues such as the assessment, approval, reporting and disclosure of related party transactions involving Chinese listed companies largely remain the sphere of stock exchange rules. 《上海证券交易所股票上市规则（2012年修订）》 (People's Republic of China) [Shanghai Stock Exchange Listing Rules 92012 Revision] (People's Republic of China) Shanghai Stock Exchange, 7 July 2012, Rule 10.2.5. 《深圳证券交易所股票上市规则（2012年修订）》 [Shenzhen Stock Exchanges Listing Rules (2012 edition)] (People's Republic of China) Shanghai Stock Exchange, 7 July 2012, Section 7.3.

²⁸ A survey of 109 listed companies controlled by central SOEs found that the total amount of this type of transactions accounted for about 67 per cent of all related party transactions involving these companies in 2010. Lu Fucai [卢福才] (ed), *Report on Corporate Governance of Central State-owned Enterprises* [中央企业公司治理报告] (China Economic Publishing House, 2011) 46.

guarantees by companies for their shareholders, or actual controllers,²⁹ to be approved by shareholders in general meeting without any votes cast by the related shareholder(s), or shareholder(s) controlled by the actual controller, irrespective of the value of the guarantee provided.³⁰ In addition, where a related party transaction is considered by the board of directors of a listed company, any director connected to the related party is prohibited from participating in the voting, or exercising voting rights on behalf of other directors.³¹ These specific rules are complimented by a general provision that imposes the civil liability of compensation on a broad range of corporate controllers and company officers (including controlling shareholders, actual controllers, directors, supervisors and senior managers) who cause any loss to the company by taking advantage of their 'affiliated relations'.³² Relevant to the protection of minority shareholders from insider control, the 2005 *Securities Law* has made some efforts to strengthen information disclosure by listed companies (as Chapter 6 discussed).

Nevertheless, of all the investor-oriented reforms introduced by the 2005 *Company Law* and the *Securities Law*, the adoption of several Anglo-American style shareholder remedies has been considered 'arguably the single most important rule of law development in China's corporate law system',³³ and representing 'a broader formal shift in the Company Law towards a greater emphasis on judicial power and the *ex post* remedies instead of *ex ante* supervision by administrative agencies'.³⁴

First, Article 152 introduced a long-awaited Anglo-American style statutory derivative action which allows shareholders meeting certain criteria to file a lawsuit for the recovery of loss suffered by their company, where the latter has refused or failed to do

²⁹ 'Actual controller' is defined in the 2005 *PRC Company Law* as anyone who is not a shareholder but is able to exercise actual control of the acts of the company by means of investment relations, agreements or any other arrangements. 2005 *PRC Company Law* art.217(3).

³⁰ Ibid art 16.

³¹ Ibid art 125. The Article also provides that where the number of connected directors present at the meeting of the board is less than three persons, the matter shall be submitted to the general meeting for consideration.

³² Ibid art 21. 'Affiliated relations' are broadly defined as the relations between these persons and 'the enterprises under their direct or indirect control, and any other relations which may result in the transfer of company interests'. Note however, 'affiliated relations do not exist among companies controlled by the state despite that the state holds shares in all these companies'. 2005 *PRC Company Law* Article 217(4).

³³ Jiangyu Wang, 'Rule of Law and Rule of Officials: Shareholder Litigation and Anti-Dumping Investigation in China' (The Foundation for Law, Justice and Society in collaboration with The Centre for Socio-Legal Studies, University of Oxford) 3 <<http://www.fljs.org/uploads/documents/Jiangyu%231%23.pdf>>

³⁴ Donald Clarke and Nicholas Howson, 'Pathway to Minority Shareholder Protection: Derivative Actions in the People's Republic of China' in D. Puchniak et al. (eds), *The Derivative Action in Asia: A Comparative and Functional Approach* (Cambridge University Press, 2012) 243, 243.

so.³⁵ Article 150 of the new *Company Law* requires a director, supervisor or senior manager who violates the provisions of laws, administrative regulations or the company constitution in their performance of duties, thereby causing a loss to the company to bear the liability for compensation. Where a violation referred to in Article 150 involves a director or a senior manager, Article 152 allows a shareholder (or group of shareholders) satisfying certain shareholding threshold to request the board of supervisors to file a lawsuit with a people's court. Where the board of supervisors refuse or fail to do so within 30 days, or in case of an emergency, the aforementioned shareholders may file the law suit to protect the interests of the company.

Several direct actions have also been introduced by the new *Company Law* and the *Securities Law* to assist aggrieved investors in seeking judicial protection of their shareholder rights. For example, Article 153 allows an aggrieved shareholder to file a lawsuit against a director or a senior manager, where the interests of the shareholder have been damaged by the wrongdoer in breach of any law, administrative regulation or the company constitution. Article 22 allows shareholders to apply to the court to set aside a resolution of the general meeting or board of directors for certain substantive or procedural irregularities.³⁶ Shareholders may also apply to the court to wind up a company where due to serious difficulty in business operations, the continuing existence of the company would cause major loss to the interests of the shareholders.³⁷ These remedies are further complemented by an expanded civil liability regime for securities market misconduct. As discussed below, this regime only captured securities-related misrepresentations under the 1998 *Securities Law*. The new *Securities Law* extends the liability for compensation to other types of securities market misconduct, including insider trading and market manipulation.³⁸

Extensive legislative changes aside, an increased focus on investor protection in China's post-2005 regulatory framework has led to the adoption of numerous regulatory initiatives in this area.³⁹ For example, the CSRC has taken measures to tackle the low dividend payout ratio of Chinese listed companies. In Anglo-American jurisdictions,

³⁵ 2005 PRC *Company Law* art 152.

³⁶ Ibid art 22.

³⁷ Ibid art 183. Under Article 143, shareholders may also require their companies to buy back their shares where they disagree with a company resolution on mergers or split-up.

³⁸ 2005 PRC *Securities Law* arts 76, 77.

³⁹ As noted in Chapter 6, the CSRC has updated many of its regulations concerning various aspects of corporate governance following the passage of the 2005 *Company Law* and the *Securities Law*.

setting dividend policy is usually a matter for the board of directors.⁴⁰ However, the practice of paying very small or no dividends was fairly common among companies listed on the Chinese stock market. This not only rendered the stock market a source of 'free lunch financing' for the controlling shareholders of the listed companies,⁴¹ but also led many investors to adopt a highly speculative approach to investments on the Chinese stock market (as they see little prospect in long-term shareholding in the companies). To encourage dividend payments, the CSRC has, since 2008, made the 'distribution of no less than 30 per cent of annual distributable profits as dividends over the past three years' a precondition for additional share issue by listed companies.⁴² Under the regulatory oversight of the CSRC,⁴³ the Shanghai Stock Exchange has also issued new guidelines to further encourage the payment of cash dividends by companies listed on the Exchange.⁴⁴ According to these guidelines, the Shanghai Stock Exchange will give companies with high cash dividend payout ratio (no lower than 50 per cent of annual distributable profits) preferential treatment in approving their applications for further fundraising and takeover activities. By contrast, companies that distribute less than 30 per cent of annual distributable profits as cash dividends are required to explain the reason in their annual directors' reports.⁴⁵

Other measures taken by the CSRC to enhance investor protection on the stock market have included the following: First, to continue to foster institutional investment, the CSRC, in conjunction with other central government regulators, have allowed financial institutions, including banks and QFIIs, greater access to the domestic stock market.⁴⁶ As part of these efforts, foreign strategic investors have also been allowed to invest in Chinese listed companies.⁴⁷ Second, under the regulatory oversight of the CSRC, the

⁴⁰ For example, this is provided in Australian *Corporations Act 2001* (Cth) s 254U as a replaceable rule.

⁴¹ Shanghai Stock Exchange, *China Corporate Governance Report* (2003) 21 <<http://rru.worldbank.org/Discussions/OpenFile.aspx?id=1284,21>>.

⁴² 《关于修改上市公司现金分红若干规定的决定》 [Decision on the Revision of Several Provisions Concerning Cash Dividend Distribution by Listed Companies] (People's Republic of China) China Securities Regulatory Commission, 7 October 2008.

⁴³ 《上海证券交易所上市公司现金分红指引》 [Shanghai Stock Exchange Guidelines on Distribution of Cash Dividends by Listed Companies] (People's Republic of China) Shanghai Stock Exchange, 7 January 2013.

⁴⁴ Ibid art 13.

⁴⁵ Ibid art 8.

⁴⁶ '郭树清: 增加机构投资者比重 鼓励养老基金入市' [Guo Shuqing: Increasing Institutional Investment by Encouraging Social Security Funds to Enter into the Market], *Chinese Economic Weekly* (online) (2 February 2012) <<http://www.ceweekly.cn/html/zbscpd/201202024273509386.html>>.

⁴⁷ 《外国投资者对上市公司战略投资管理办法》 [Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors] (People's Republic of China) Ministry of Commerce, China Securities Regulatory Commission, State Administration of Taxation, State Administration for Industry and Commerce and

Shanghai and the Shenzhen Stock Exchanges have released rules to tighten China's largely non-existent delisting system. It was anticipated that with poor-performing companies being removed from the market in a timely fashion, the overall quality of listed companies would be significantly improved.⁴⁸ Furthermore, in an effort to tackle the excessively high share issue prices, the CSRC has recently restated its intention to undertake further reforms of procedures for initial public offering and listing of company shares.⁴⁹

To enhance investor protection in listed SOEs, SASAC has also issued various rules and guidelines post the 2005 corporate law reforms. For example, in a 2009 policy document entitled *Several Opinions on the Standardisation of Behaviour of State Shareholders in Listed Companies*,⁵⁰ SASAC requires all state shareholders to 'provide a role model in maintaining the healthy development of the capital market' by, among other things, 'abiding by law and good faith, standardising operations, fulfilling corporate social responsibility and supporting their listed subsidiaries to become better and stronger companies'.⁵¹ Although a policy document is not legally enforceable, the binding force of this document is lent by SASAC's extensive decision-making powers over central SOEs (as discussed in Chapter 6). Other regulations and guidelines issued by SASAC deal with a wide range of issues relating to shareholder protection in listed SOEs. These include the prohibition of state shareholders from competition with their

State Administration of Foreign Exchange, 31 December 2005. A foreign strategic investor is defined by the *Measures* as a foreign entity that has an equity interest of at least 10 per cent in a Chinese listed company for at least three years.

⁴⁸ 《关于完善上海证券交易所上市公司退市制度的方案》 [Plan on Improving the Delisting System of Companies Listed on the Shanghai Stock Exchange] (People's Republic of China) Shanghai Stock Exchange, 28 June 2012; 《关于改进和完善深圳证券交易所主板、中小企业板上市公司退市制度的方案》 [Plan on Improving the Delisting System for Companies Listed on the Main board and the Medium to Small Enterprises Board of the Shenzhen Stock Exchange] (People's Republic of China) Shenzhen Stock Exchange, 28 June 2012.

⁴⁹ 《关于进一步改革和完善新股发行体制的指导意见》 [Guiding Opinion on Further Reforming and Improving the System of Initial Public Offering] (People's Republic of China) China Securities Regulatory Commission, 10 June 2009.

⁵⁰ 《关于规范上市公司国有股东行为的若干意见》 [Several Opinions on Standardising the Practices of State-owned Shareholders in Listed Companies] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 3 July 2009.

⁵¹ Ibid.

listed subsidiaries,⁵² reorganisation of assets between listed companies and their state shareholders and the handling of inside information by state shareholders.⁵³

Indeed, by drawing upon mechanisms of corporate governance from the Anglo-American outsider-based model, China's post-2005 regulation of investor protection presents a far more investor-friendly approach compared to its pre-2005 framework. Nevertheless, increased shareholder protection does not necessarily mean that the governance of listed SOEs in China post-2005 is moving towards the Anglo-American shareholder-oriented model. As the review of China's post-2005 regulation of non-shareholder stakeholder protection below will demonstrate, China's recent move towards an all-encompassing approach to those two sets of company relations distinguishes the Chinese model from the Anglo-American model.

7.3.2 Other stakeholder protection

As noted in Chapter 3, Ho distinguished three models of corporate social responsibility based on the role of the state in promoting corporate social responsibility in the US, Europe and China. These are the market-driven model represented by the US, the relational model represented by member states of the European Union and the state-centric model that applies to China.⁵⁴

China's post-2005 reform of non-shareholder stakeholder protection reflects the emergence of a state-centric approach as postulated by Ho. In this model, rather than acting through (as in the market-driven model) or in partnership with (as the relational model) civil society organisations, the state plays a leading role in advancing corporate social responsibility through legislation and regulatory enforcement.⁵⁵ As discussed next, with the legal foundation for corporate social responsibility provided in the 2005 *Company Law*, many administrative regulations and guidelines have been issued to assist in its implementation. Through these regulations and guidelines, mandatory

⁵² 《关于推动国有股东与所控股上市公司解决同业竞争 规范关联交易的指导意见》[Guiding Opinion on the Resolution of Competition between State Shareholders and their Controlled Listed Subsidiaries and Standardisation of Related Party Transactions] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 20 August 2013.

⁵³ 《关于规范国有股东与上市公司进行资产重组有关事项的通知》[Notice on Relevant Issues Concerning the Regulation of Assets Reorganisation between State-owned Shareholders and Listed Companies] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 24 June 2009; 《关于加强上市公司国有股东内幕信息管理有关问题的通知》[Notice on Issues Concerning Strengthening the Management of Insider Information by State-owned Shareholders of Listed Companies] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 28 October 2011.

⁵⁴ Ho, above n 7, 423-6.

⁵⁵ Ibid 424-5.

disclosure of social and environmental information has also been imposed on certain categories of listed companies (including state-controlled listed companies) and central SOEs. As noted by Ho, the proliferation of state-led initiatives on corporate social responsibility has placed China a leader among 'many of its emerging market peers and even many Organisation for Economic Cooperation and Development (OECD) countries in the level of government support for CSR [corporate social responsibility]'.⁵⁶ Indeed, as will be illustrated with the case study on the 2008 tainted milk scandal in Chapter 9, Chinese state-led initiatives on corporate social responsibility post-2005 are not limited to formal legal means. Many administrative, and often *ad hoc* means, have been utilised by the central and local governments to mitigate conflicts between companies and their outsider stakeholders, including tort victims and trade creditors.

The first most noticeable change in this regard has been the institution of corporate social responsibility in the 2005 *Company Law*. There are many mechanisms outside the corporate law regime that may play an important - although indirect - role in promoting corporate social responsibility. For example, in the Anglo-American countries, the choices made by managers in corporate decision-making are shaped by legislation in many areas, such as industrial relations, environmental protection, competition law and public procurement law.⁵⁷ China is no exception in this regard.⁵⁸ However, state mandating corporate social responsibility through the system of corporate law distinguishes China's post-2005 regulation of stakeholder protection from both the former state-led and the Anglo-American models. Article 5 of the revised *Company Law* states that in their business operations companies shall:

[c]omply with the provisions of laws and administrative regulations, uphold social morality, business ethics, honesty and trustworthiness, accept supervision of the government and the public, and bear **social responsibility** [emphasis added].⁵⁹

⁵⁶ Ibid 379.

⁵⁷ Adam Winkler, 'Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History' (2004) 67 *Law and Contemporary Problems* 109, 111

⁵⁸ In the Chinese context, the National People's Congress has issued many laws including the *Employment Contract Law*, the *Renewable Energy Resources Law*, the *Law on the Preservation of Energy Resources* and the *Law on Promotion of Sustainable Economy*. These laws set forth requirements relating to various corporate social and environmental responsibilities. In addition, China's post-2005 regulation of corporate social responsibility has been assisted by a plethora of 'soft tools' to elicit compliance, such as the MEP's 'green finance programs' that tie tax incentives and direct subsidiaries to company environmental compliance. See Ho, above n 7, 401-4; Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' 2010 (28) *Berkeley Journal of International Law* 64, 79-81.

⁵⁹ 2005 PRC *Company Law* art 5.

As noted by Hawes, in the absence of any stipulation as to the scope of corporate social responsibility and the relevant consequences of non-compliance, the enforceability of Article 5 is unclear.⁶⁰ Nevertheless, the message promoted by Article 5 is clear. Companies should strive for more than merely maximising shareholder wealth.

The general principle of Article 5 is supplemented by a number of provisions that provide better protection of specific groups of company stakeholders. For example, to enhance the legal protection of creditors, the 2005 *Company Law*, in broad terms, adopts aspects of the Anglo-American doctrine of 'piercing the corporate veil'.⁶¹ Article 20(3) provides that

Where a shareholder of a company evades debts by abusing the independent status of the company as a legal person or the limited liability of shareholders, and thus seriously damages the interests of company creditors, it shall assume joint liability for the debts of the company.

Employees are also better protected under the new *Company Law*. In an effort to strengthening employee representation on the supervisory board of joint stock companies, Article 118 sets out the one-third minimum ratio for supervisors elected by employees.⁶² The roles of the trade union and employee representative congress in corporate decision-making have also been reinforced. While reiterating the legal presence of unions in companies, Article 18 entitles them to represent employees to enter into collective employment contracts with their companies. Article 18 further requires companies to solicit opinions from their unions and employees, when making major decisions concerning business operations or formulating important internal rules.⁶³

With the statutory basis laid in the new *Company Law*, corporate social responsibility has quickly become an important subject for administrative regulations and stock exchange listing rules and guidelines. As noted in Chapter 6, five central government agencies, including the CSRC, jointly issued the *Basic Standards for Enterprise*

⁶⁰ Colin Hawes, 'Interpreting the PRC Company Law through the Lens of Chinese Political and Corporate Culture' (2007) 30 *University of New South Wales Law Journal* 813, 813; Also see 潘学敏 [Pan Xuemin], 《浅析我国公司的社会责任》 [A brief Examination of Corporate Social Responsibility in Our Country] (2012) 6 *法治与社会 Law and Society* 78, 78.

⁶¹ 2005 *PRC Company Law* art 20.

⁶² 2005 *PRC Company Law* art 118(2). The 1993 *Company Law* provided for employee representation on the supervisory board but did not specify the minimum ratio. 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993, art 124.

⁶³ 2005 *PRC Company Law* art 18.

Internal Control (Basic Standards) in 2008.⁶⁴ The *Basic Standards* treat corporate social responsibility as an integral component of enterprise internal controls,⁶⁵ which must be established in all listed companies.⁶⁶ Further, the *Application Guideline No. 4* issued by the five government agencies to assist the implementation of the *Basic Standards* sets out four categories of corporate social responsibility-related risks that should be managed by all listed companies.⁶⁷ These include work safety, product (including service) quality, environmental protection and resource efficiency, promotion of employment and protection of employee rights and interests. The *Application Guideline No.4* also requires listed companies to fulfil their social and public obligations by 'caring for socially disadvantaged groups and supporting philanthropic activities'.⁶⁸ Furthermore, the *Application Guideline No.5* requires listed companies to build a 'corporate culture' that contributes to better corporate image and greater employee cohesion.⁶⁹ Under the regulatory oversight of the CSRC, the Shanghai and Shenzhen Stock Exchanges have also released guidelines on corporate social responsibility for companies listed on their respective exchanges.⁷⁰

For central SOEs (most of which are parent SOEs of state-controlled listed companies), SASAC has also issued corporate social responsibility guidelines. Particularly, the *Guiding Opinion on the Implementation of Corporate Social Responsibility by Central Government-affiliated SOEs (Guiding Opinion)* requires all central SOEs to integrate

⁶⁴ 《企业内部控制制度基本规范》 [Basic Standards for Enterprise Internal Control] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 22 May 2008 ('*Basic Standards*').

⁶⁵ Ibid art 18.

⁶⁶ 《关于印发《企业内部控制基本规范》的通知》 [Circular on Release of the Basic Standards for Enterprise Internal Control] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 22 May 2008.

⁶⁷ 《企业内部控制应用指引第 4 号——社会责任》 《企业内部控制应用指引第 4 号——社会责任》 [Enterprise Internal Control Application Guideline No.4 - Social Responsibility] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 15 April 2010.

⁶⁸ Ibid art 21.

⁶⁹ 《企业内部控制应用指引第 5 号——企业文化》 [Enterprise Internal Control Application Guideline No.5 - Corporate Culture] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 15 April 2010, art 2.

⁷⁰ 《深圳证券交易所上市公司社会责任指引》 [Guidelines on Social Responsibility of Companies Listed on the Shenzhen Stock Exchange] (People's Republic of China) Shenzhen Stock Exchange, 25 September 2006. 《关于加强上市公司社会责任承担工作暨发布〈上海证券交易所上市公司环境信息披露指引〉的通知》 [Notice on Strengthening Listed Companies' Assumption of Social Responsibility and the Release of the Shanghai Stock Exchange Guidelines on Disclosure of Environmental Information by Listed Companies] (People's Republic of China) Shanghai Stock Exchange, 14 May 2008.

corporate social responsibility 'into corporate governance and business strategy, and implement it on all levels of their daily operations'.⁷¹ For financial sector SOEs that fall outside SASAC's control, a similar guiding opinion has been issued by the China Banking Supervision Commission.⁷²

SASAC's *Guiding Opinion* sets out eight categories of social responsibility that should be assumed by central SOEs. Interestingly, in addition to the four categories contained in the *Application Guideline No.4* discussed above, these include some shareholder-oriented objectives such as improving the sustainability of company profit-making, innovation and technology.⁷³

The *Guiding Opinion* also sets out some measures that should be adopted by central SOEs to strengthen their corporate social responsibility. For example, the *Guiding Opinion* requires central SOEs to 'identify a department to deal with corporate social responsibility affairs; gradually build a statistical index and assessment system for corporate social responsibility'.⁷⁴ It further encourages central SOEs to 'exchange concepts and experience in fulfilling corporate social responsibility with other enterprises at home and abroad' and to 'engage in more dialogues and communication with relevant international organisations'.⁷⁵ Importantly, the *Guiding Opinion* requests central SOEs to 'give full play to the core role of the company-based Party committees' in the implementation of corporate social responsibility and encourages other Party-sponsored organisations, such as the trade unions and the women's federation, to contribute to the efforts of improving corporate social responsibility.⁷⁶

⁷¹ 《关于中央企业履行社会责任的指导意见》 [Guiding Opinion on the Implementation of Corporate Social Responsibility by Central Government-affiliated SOEs] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 29 December 2007 ('*Guiding Opinion on Corporate Social Responsibility*'), art 17.

⁷² 《关于加强银行业金融机构社会责任的意见》 [Opinion on Strengthening the Social Responsibility of Banking Financial Institutions] (People's Republic of China) China Banking Supervision Commission; 5 December 2007; 《中国银行业金融机构企业社会责任指引》 [Guidelines on Social Responsibility of Banking Financial Institutions in China] (People's Republic of China) China Banking Industry Association, 1 December 2009.

⁷³ *Guiding Opinion on Corporate Social Responsibility*, arts 8-15

⁷⁴ Ibid art 17.

⁷⁵ Ibid art 19.

⁷⁶ Ibid art 20. Similarly, to 'fully utilise the role of the grass-roots Party organisations and mass organisations' is also a strategy provided in the 'Guiding Opinion on Strengthening the building of corporate culture in centrally controlled enterprises' issued by SASAC in 2005. See 《关于加强中央企业企业文化建设的指导意见》 [Guiding Opinion on Strengthening the Building of Corporate Culture in Central Government-affiliated SOEs] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 16 March 2005, art 16.

In addition to increased requirements for compliance, there has been a growing trend of mandatory disclosure on corporate social responsibility. Although widely considered an effective tool in promoting corporate social responsibility,⁷⁷ corporate social and environmental disclosure has largely remained voluntary in most Anglo-American jurisdictions.⁷⁸ However, post-2005, more and more Chinese listed companies have been required to issue corporate social responsibility reports under administrative regulations and stock exchange rules. For example, the Shenzhen Stock Exchange has made the issue of annual corporate social responsibility reports compulsory for companies included in the SZSE (Shenzhen Stock Exchange) 100 Index, while encouraging all other companies listed on the Exchange to do so.⁷⁹ These reports must disclose company performance of social responsibility in several prescribed areas, including protection of the interests of minority shareholders, creditors, clients and consumers, environmental protection and sustainable development. They also need to describe how corporate social responsibility is managed in the listed company.⁸⁰

Three categories of companies listed on the Shanghai Stock Exchange have also been required to issue annual corporate social responsibility reports. These include companies in the Shanghai Stock Exchange Corporate Governance Index, companies that have issued shares overseas in foreign currency, and financial companies.⁸¹ In addition to the items required in the corporate governance guidelines issued by the Shenzhen Stock Exchange, companies that fall under these three categories are required to disclose their 'social contribution value per share' (representing the values a company created for its shareholders as well as non-shareholder stakeholders including employees, clients, creditors, community and society) in their corporate social responsibility reports and have the reports verified by independent practitioners.⁸²

Furthermore, as a result of a series of efforts made by the Ministry of Environmental Protection, formerly the State Environmental Protection Administration, disclosure of

⁷⁷ Corporations and Markets Advisory Committee, above n 1, 115-6; Li-Wen Lin, above n 58, 74.

⁷⁸ Corporations and Markets Advisory Committee, above n 1, 125-35.

⁷⁹ 《关于做好上市公司 2008 年年度报告工作的通知》 [Notice on the Preparation of the 2008 Annual Reports by Listed Companies] (People's Republic of China) Shenzhen Stock Exchange, 31 December 2008.

⁸⁰ Ibid.

⁸¹ Ibid.

⁸² Ibid.

environmental information has also become compulsory for companies on the 'high polluting companies' lists' maintained by central and local environmental agencies.⁸³

For central SOEs, SASAC had required them to publish periodical social responsibility reports or sustainability reports to disclose their performance, systems and future plans in managing corporate social responsibility by the end of 2012.⁸⁴

Indeed, with the introduction of the *Basic Standards*, corporate social responsibility disclosure may well become mandatory for all listed companies in China. The *Basic Standards* require the board of directors of listed companies to issue their annual self-evaluation reports and independent auditors' reports on the effectiveness of their internal controls, of which corporate social responsibility is an essential component as noted earlier.⁸⁵ As the first batch of listed companies earmarked to implement these requirements, listed SOEs were mandated to issue their first self-evaluation reports with the release of their 2012 annual reports.⁸⁶

7.4 Post-2005 regulation of investor and other stakeholder protection: what has not changed?

This chapter has so far reviewed changes in China's post-2005 regulation of shareholder and other stakeholder protection in listed SOEs. The regulation stands as a remarkable contrast with the Chinese pre-2005 state-led model in two important aspects. The first is the level of emphasis placed by the state on the protection of minority shareholders and non-shareholder stakeholders, and the second, the range of non-shareholder stakeholders that are brought under protection.

⁸³ 《环境信息公开办法（试行）》 [The Measures on Environmental Information Disclosure (for Trial Implementation)] (People's Republic of China) State Environmental Protection Administration, 11 April 2007. Pursuant to the *Measures*, the Shanghai Stock Exchange has also released relevant guidelines for listed companies. See 《上海证券交易所上市公司环境信息披露指引》 [Shanghai Stock Exchange Guidelines on Disclosing Environmental Information by Listed Companies] (People's Republic of China) Shanghai Stock Exchange, 14 May 2008; 《上市公司环境信息披露指南（征求意见稿）》 [Guidelines for Environmental Information Disclosure by Listed Companies (Draft for Comments)] (People's Republic of China) Ministry of Environmental Protection, 14 September 2010.

⁸⁴ State-owned Assets Supervision and Administration Commission, '2011 年中央企业社会责任报告专题分析报告' [Analysis of 2011 Social Responsibility Reports Issued by Central Government-affiliated SOEs] <www.sasac.gov.cn/n1180/n13307665/n13307681/.../n14452725.doc>.

⁸⁵ 《关于印发〈企业内部控制基本规范〉的通知》 [Circular on Release of the Basic Standards for Enterprise Internal Control] (People's Republic of China) Ministry of Finance, China Securities Regulatory Commission, National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, 22 May 2008; *Basic Standards* art 10.

⁸⁶ 《关于 2012 年主板上市公司分类分批实施企业内部控制规范体系的通知》 [Notice on the Implementation of the System of Enterprise Internal Control by Companies Listed on the Main Board under Different Categories and Groups from 2012] (People's Republic of China) Ministry of Finance and China Securities Regulatory Commission, 14 August 2012.

Yet, despite significant changes, the dominance of the state in structuring these two sets of company relations distinguishes the current Chinese approach from both the Anglo-American and the broader stakeholder governance models, and continues to align this approach with the former state-led model. In relation to shareholder protection, the ongoing dominance of the state has meant that unlike the Anglo-American outsider-based model, unbridled shareholder activism has not been encouraged under the new framework. As the discussion below will suggest, ongoing control of shareholder activism, especially organised activism, has been facilitated by the 'watered down' version of many of the transplanted rules in the company law, as well as a persistent reluctance of the courts to handle securities-related private lawsuits. As the discussion of the continuities in Chinese post-2005 regulation of non-shareholder stakeholder protection below will further suggest, in this regard, non-shareholder stakeholders are not in a stronger position than shareholders. Various obstacles remain within both within and outside the corporate law to hold non-shareholder stakeholder activism in check. As discussed in Chapter 8, the ongoing centrality of the state in China's post-2005 regulation of investor and other stakeholder protection means that, similar to the former post-war state-led model, this approach serves as an instrument of the state to promote policy goals.

7.4.1 Investor protection

First, as discussed in the previous section, the 2005 *Company Law* has introduced various mechanisms to strengthen shareholder participation in corporate governance. These mechanisms, however, might not help to increase the voice of minority shareholders to a great extent. This is particularly so with the very high shareholding thresholds for invoking those mechanisms and the dispersed nature of minority shareholding in Chinese listed companies. The average shareholding for the largest shareholders in all listed companies was about 39 per cent in 2009. This figure was even higher for larger listed SOEs.⁸⁷ With this level of ownership concentration, neither the 10 per cent threshold for convening a general meeting, nor the three per cent for proposing a shareholder resolution, can be easily met by any single institutional investor, let alone small individual investors.⁸⁸

⁸⁷ 刘文达 [Liu Wenda], 《审计需求之代理理论新探》 [Exploring Agency Theory on Demand for Auditing] (2011) 7 财会月刊 Financial and Accounting Monthly 72, 73.

⁸⁸ 朱慈蕴等 [Zhu Ciyun et al], '资本市场创新发展新格局与《公司法》的修订完善' [Innovation and Development of the Capital Market and Future Reform of the Company Law] (2012 上证联合研究计划

Nor has the system of cumulative voting for board election proved to be very effective under this shareholding structure. There have been few reported cases of successful use of the system in Chinese listed companies. This is despite the fact that cumulative voting for the election of directors has been mandated by the CSRC since 2002, for listed companies with a more than 30 per cent controlling shareholder.⁸⁹ In the 2012 board election of Gree Electric Appliances Inc., several institutional shareholders replaced a local government nominee with one of their preferred candidates by combining their cumulative voting powers.⁹⁰ This event has been hailed as a milestone in the development of corporate governance in China. However, the 20 per cent shareholding held by its state-owned parent in Gree is relatively low compared to the average shareholding of the largest shareholders in listed companies in China which is discussed above.

Second, there are significant legal and judicial obstacles for minority shareholders to overcome when seeking to rely upon any of the new shareholders' remedies. At the outset, it should be noted that the shareholder derivative action is not widely used even in many Anglo-American jurisdictions including Australia.⁹¹ This is, in part, due to the inherent economic disincentive associated with this particular type of action.⁹² A derivative action means that should the applicant shareholder win the case, any benefit recovered accrues to the company, not the shareholder personally. However, should the applicant lose the case, in jurisdictions where the English rule as to costs is applied, they bear the additional risk of having to pay the costs of the defendant.⁹³

[Shanghai Stock Exchange Joint Research Program 2012] No.22) para 3.2
<http://www.sse.com.cn/cs/zhs/xxfw/research/plan/plan20120523a.pdf>

⁸⁹ CSRC Code of Corporate Governance art 31.

⁹⁰ 彭勇, 刘大江, [Peng Yong and Liu Dajiang], '格力电器 "空降董事" 遭否上市公司治理走向博弈时代' ["Descending from Heaven Director" Rejected by Gree--- The Arrival of a New Era for Governance of Listed Companies], *Xinhua Net News Story* (28 May 2012) <http://gd.xinhuanet.com/newscenter/2012-05/28/content_25309136.htm>.

⁹¹ Ian M Ramsay and Benjamin B Saund, 'Litigation by Shareholders and Directors: an Empirical Study of the Statutory Derivative Action' (Melbourne Law School Legal Studies Research Paper No. 250, 12 August 2005) <<http://ssrn.com/abstract=914465>>. In the US, these economic disincentives have, in part, been countered by method for awarding attorney fees. The 'lodestar' method, which allows attorneys to be compensated for their work done where no monetary relief has been awarded from an action, drives lawyers to function more like "entrepreneurs," using the applicant's name only as a key to the courtroom. Lang Thai, 'How Popular are Statutory Derivative Actions in Australia? Comparisons with United States, Canada and New Zealand' (2002) 30 *Australian Business Law Review* 118, 124; Cindy Schipani, 'Corporate Governance and Shareholder Remedies: The US Experience and Australia's Proposals for Reform' (1994) 6 *Bond Law Review* 28.

⁹² Roberta Romano, 'The Shareholder Suit: Litigation without Foundation?' (1991) 7 *Journal of Law, Economics & Organization* 55, 55-56; Ian Ramsay, 'Corporate Governance, Shareholder Litigation and the Prospect for a Statutory Derivative Action' (1992) 15 *UNSW Law Journal* 149, 163.

⁹³ Ramsay, above n 92, 163.

Economic disincentive aside, minority shareholders in Chinese companies are confronted with significant legal and judicial obstacles in commencing a statutory derivative action under the 2005 *Company Law*. To name a few, unlike an Anglo-American style derivative action that allows an applicant shareholder to sue in the name of the company, Article 152 of the new *Company Law* only allows the shareholders to sue in their own name. This limitation raises the doubt as to the very existence of a derivative action under the new *Company Law*.⁹⁴ Further, unlike the Australian *Corporations Act* 2001 that grants all shareholders (and even non-shareholders under certain circumstances) a right to bring a derivative action with the leave of a court,⁹⁵ the 2005 *Company Law*, in relation to joint stock companies, only allows shareholder(s) holding more than one per cent company shares for at least 180 consecutive days to sue.⁹⁶ Given the highly dispersed nature of public shareholding in listed companies in China, this minimum shareholding requirement can be extremely difficult to meet.⁹⁷ The cost of litigation is another burden faced by shareholders considering a derivative action.⁹⁸ Under the Chinese civil litigation system, the plaintiff who files a lawsuit is generally required to pay upfront a filing fee calculated on a sliding scale in accordance with the amount claimed.⁹⁹ As pointed out by Tan and Wang, in the absence of any provision for the indemnification of legal costs out of company funds, most shareholders would not attempt an expensive derivative action which might not result in benefits to the shareholders personally.¹⁰⁰ This is particularly

⁹⁴ One might argue that s152 is intended as a personal action, which could strengthen the position of the shareholders. However, the s152 action can be brought only where the company has suffered a loss due to conduct of a director or senior manager and the board of supervisors refuses to take legal proceedings against the wrong doer after receiving written request from the applicant shareholder. The action must also be brought by the applicant in the 'interest of the company' instead of the applicant shareholder personally.

⁹⁵ *Corporations Act* 2001 (Cth) ss 236, 237.

⁹⁶ 2005 *PRC Company Law* art 152.

⁹⁷ Lay Hong Tan and Jiangyu Wang, 'Modelling an Effective Corporate Governance System for China's Listed State-Owned Enterprises: Issues and Challenges in a Transitional Economy' (2007) 7 *Journal of Corporate Law Studies* 143, 163.

⁹⁸ Hui Huang, 'The Statutory Derivative Action in China: Critical Analysis and Recommendations for Reform' (2007) 4 *Berkeley Business Law Journal* 227, 248.

⁹⁹ The sliding scale is from 2.5 to 0.5 per cent depending on the amount of the claim. 《诉讼费用交纳办法》 [Measures on the Payment of Litigation Costs] (People's Republic of China) State Council, 19 December 2006, art 20.

¹⁰⁰ This can be contrasted to the Australian regime which grants the court wide discretion in making cost orders. *Corporations Act* 2001 (Cth) s 242; Tan and Wang, above n 97, 162-3.

so where they have to bear the costs of litigation (albeit excluding lawyers' fees) of the other side following an unsuccessful suit.¹⁰¹

The usefulness of the direct suit introduced by Article 153 as a shareholders' remedy may also be easily overstated. Under that Article, the right of a shareholder to bring a direct suit is premised upon a wrongdoing of a director or senior manager in breach of laws, administrative regulations or company constitution. In other words, even where a loss has been suffered by a shareholder as result of the above persons' conduct, such an action cannot be maintained without the shareholder also establishing a clear breach of any of the above three sets of rules by the relevant director or senior manager. This latter precondition renders the Article 153 remedy much narrower, compared to an Australian-style statutory oppression remedy that focuses on the nature, rather than the legality, of the conduct in question.¹⁰²

In addition to significant legal obstacles, the reluctance of the courts to hear securities-related litigation creates a further disincentive for minority shareholders to rely upon any of the newly introduced shareholder remedies. As noted in Chapter 5, this reluctance has been manifested in the Supreme People's Court (SPC)'s interpretation of private lawsuits concerning loss caused by securities-related misstatement. Although these actions were created by the 1998 *Securities Law*,¹⁰³ they were made available to investors of listed companies only where the alleged wrongdoing had been subject to an administrative sanction or a criminal conviction.¹⁰⁴ It is true that in Anglo-American jurisdictions such as Australia, private proceedings are often delayed until after regulatory action, as the costs of private proceedings are high.¹⁰⁵ However, as explained in Chapter 5, for various reasons, such as local protectionism and the dual role of the CSRC as a regulator and stock market developer, enforcement activity by the CSRC has been low, which inevitably limits shareholders' access to the judicial system. However, in the absence of any contrary provisions introduced by the 2005 *Securities Law*, this restrictive interpretation by the SPC has remained in force.

¹⁰¹ 《诉讼费用交纳办法》 [Measures on the Payment of Litigation Costs] (People's Republic of China) State Council, 19 December 2006, arts 6 and 29.

¹⁰² *Corporations Act 2001* (Cth) s 232.

¹⁰³ 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1998, art 63.

¹⁰⁴ 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Several Provisions on Hearing Civil Cases Related to Securities Market Misrepresentation] (People's Republic of China) Supreme People's Court, 9 January 2003, art 5.

¹⁰⁵ Conversation with Professor Peta Spender, ANU College of Law, 13 May 2013.

Moreover, the difficulty faced by shareholders in seeking judicial redress has been exacerbated by the prohibition of shareholder class action in China. In many common law jurisdictions, despite various controversies surrounding its relative merits,¹⁰⁶ class action has served as an increasingly popular means for large groups of shareholders to obtain relief for their similar claims arising from the same or similar circumstances. This is particularly so 'where the claim is so small as to be individually untenable'.¹⁰⁷ In Australia, a remarkable growth in these actions in recent years has further generated a popular perception that a shareholder class action can be 'likened to a sheriff' in deterring corporate misconduct.¹⁰⁸

However, shareholder class actions are banned in China. The 1991 *Civil Procedure Law*¹⁰⁹ provides for two types of collective actions where either party involves a large number (defined as ten or more persons) of litigants. The first type, the Article 54 action, concerns 'representative suits with fixed number of litigants'.¹¹⁰ The second, the Article 55 action refers to representative suits where the number of litigants comprising one party is not fixed at the commencement of the action.¹¹¹ While Article 54 is modelled on the Japanese style representative action, Article 55 draws upon the US-style class action.¹¹² Through a notice issued in 2002, the SPC made it clear that plaintiffs of securities-related civil action can adopt 'representative suits with a fixed number of litigants, but not 'collective law suit with non-fixed number of litigants' (*Jituan Susong*).¹¹³

It is unlikely that this prohibition of shareholder class action will be lifted in the immediate future, in view of the more recent introduction of stricter control over

¹⁰⁶ For arguments for and against class actions, see Peter Cashman, *Class Action Law and Practice* (The Federation Press, 2007) 22-25.

¹⁰⁷ Peta Spender, 'The Class Action as Sheriff: Private Law Enforcement and Remedial Roulette' (ANU College of Law Research Paper No. 08-24) 7 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1224642>.

¹⁰⁸ *Ibid* 3.

¹⁰⁹ 《中华人民共和国民事诉讼法》 [Civil Procedure Law of the People's Republic of China] (People's Republic of China) National People's Congress, 9 April 1991, arts 54 and 55.

¹¹⁰ *Ibid* art 54.

¹¹¹ *Ibid* art 55.

¹¹² Michael Palmer and Chao Xi, 'Collective and Representative Actions in China' National Report to the University of Oxford Centre for Social Legal Studies and Stanford Law School Joint Project on the globalisation of class actions, 4 <http://prod.law.stanford.edu/sites/default/files/event/261321/media/slspublic/China_National_Report.pdf>

¹¹³ 《最高人民法院关于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》 [Notice on Relevant Issues concerning Acceptance of Civil Tort Disputes Arising from Misrepresentation on the Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002.

plaintiff lawyers acting for mass litigation cases.¹¹⁴ The new rules introduced by the All China's Lawyers' Association (ACLA), the Chinese government-sponsored legal professional body, include a system for reporting mass litigation cases by plaintiff lawyers. Under the system, the plaintiff lawyer, upon acceptance of a mass litigation case, must file the details of the case with ACLA and be subject to its monitoring and guidance during the handling of the case. Should the case display any signs of 'conflict escalation', thereby potentially causing social unrest, the lawyer must immediately report the case to the local government.¹¹⁵ Further, the plaintiff lawyers are encouraged to settle mass litigation cases through mediation, rather than litigation, so as 'to facilitate peaceful resolution of conflicts'.¹¹⁶

It is therefore not surprising that the various shareholders' remedies introduced by the new *Company Law* have not been utilised to any great extent by minority shareholders in Chinese listed SOEs. For example, based on a dataset of Chinese judicial opinions arising in over 50 cases from 1994 to 2010, Clarke and Howson found a 'virtually complete absence of' shareholder derivative suits involving joint stock companies.¹¹⁷ Further, Howson's review of over 1000 company law-related disputes reported by courts in Shanghai from 1992 to 2008¹¹⁸ found a striking absence of cases relating to joint stock companies.¹¹⁹

This section has so far reviewed the continuities in China's post-2005 regulation of investor protection. While increased shareholder rights and remedies have provided public investors with considerable comfort, the real chance for them to exert a strong voice about corporate governance, either through participation in the general meeting or undertaking private law suits, remains quite limited.

¹¹⁴ 《关于律师办理群体性案件指导意见》 [Guiding Opinion on Lawyers Handling Mass Litigation Cases] (People's Republic of China) All China Lawyers Association, 20 March 2006.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Clarke and Howson, above n 34, 275.

¹¹⁸ These cases involve a broad range of areas such as directors' fiduciary duties, veil-piercing, shareholder derivative action, the contribution of capital and dividend distributions. See Nicholas Howson, 'Corporate Law in the Shanghai People's Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State' (2010) 5 *East Asia Law Review* 303, 345.

¹¹⁹ Ibid 400. Of course these studies should also be received with some caution. This is mainly because of difficulties associated with collecting the relevant data. As a civil law country, judicial decisions, except judicial opinions issued by the Supreme People's Court, do not carry the force of binding precedents. Chinese courts are therefore not required to report cases they have dealt with. However, some higher level courts, such as the Supreme People's Court, have increasingly published a selection of cases to guide the application of law by lower courts. Cheng Wei-qi, 'Protection of Minority Shareholders after the New Company Law: 26 Case Studies' (2010) 4 *International Law and Management* 283, 288-9.

7.4.2 Non-shareholder stakeholder protection

In terms of exerting a voice in corporate governance of listed SOEs, non-shareholder stakeholders (except employees) are even in a weaker position than shareholders. First, unlike their counterparts in the West, civil society organisations are not the main suppliers of corporate social responsibility rules and standards in China. Some industrial associations, such as the China National Textile and Apparel Council and China Electronics Enterprises Association, have contributed to the rule-making process by releasing industry-specific corporate social responsibility standards.¹²⁰ These associations, however, cannot be treated as equivalents of their Western counterparts. With their establishment and operations closely controlled by the state, these organisations mainly exist to facilitate state policy goals.¹²¹

Second, compared to shareholders, non-shareholder stakeholders have even fewer avenues to enforce their corporate law interests through private lawsuits. As noted earlier, in the absence of any provision regarding the scope of corporate social responsibility and the consequences of non-compliance, the enforceability of Article 5 of the 2005 *Company Law* is not clear.¹²² A recent amendment to the *PRC Civil Procedure Law* has allowed 'relevant bodies and organisations prescribed by the law' to commence legal proceedings against 'such acts as environmental pollution, harm of consumer interests and other acts that undermine the social and public interest'.¹²³ The persons who may have standing to sue under this amendment are however vague, and in any event do not include individuals. In this regard, it is worth noting that a recent draft amendment to the *PRC Environmental Protection Law* only allows the All-China Environment Federation (ACEF) and its local branches to commence proceedings in relation to environmental pollution incidents that have caused major damage to ecology

¹²⁰ China National Textile and Apparel Council (CNTAC), 《中国纺织企业社会责任管理体系 CSC9000T》 [China Social Compliance 9000 for Textile & Apparel Industry]. The CNTAC has also required its member enterprises to release social responsibility reports since 2006. With the Help of the CNTAC, China Electronic Enterprises Association (CEEA) is preparing its own industrial specific standards CS9000E. See Speech given by Sun Ruize, Deputy Chairman of CNTAC, at the 2012Inaugural China-Holland Corporate Social Responsibility Summit <<http://www.siccsr.org/NewsInfo.aspx?NId=2133>>

¹²¹ Ho, above n 7, 426.

¹²² Hawes, above n 60; Also see 潘学敏 [Pan Xuemin], above n 60.

¹²³ 《中华人民共和国民事诉讼法》 [Civil Procedure Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, 31 August 2012, art 55.

and public interests.¹²⁴ Although registered as a not-for-profit organisation, the ACEF is directly affiliated to the Ministry of Environmental Protection.¹²⁵

Indeed, the ongoing centrality of the state in China's post-2005 regulation of non-shareholder stakeholder protection raises doubt about the applicability of the Western concept of corporate social responsibility in China. The *Shenzhen Stock Exchange Guidelines on Social Responsibility for Listed Companies* define corporate social responsibility as:

'the responsibilities that shall be undertaken by a listed company towards the comprehensive development of the state, society, natural environment and resources, as well as responsibilities towards its shareholders, creditors, employees, clients, consumers, suppliers, communities and other stakeholders'.¹²⁶

Many other guidelines and policy statements on corporate social responsibility issued by various government and semi-government agencies tend to use the term 'corporate social responsibility' without providing a definition. The categories of stakeholders covered in those documents, however, tend to be similar.

Note that this definition is different from the Western concept of corporate social responsibility in two important aspects. First, the Shenzhen Stock Exchange's definition put 'the comprehensive development of the state' ahead of all other stakeholders that should be looked after by the companies. The dominance of the interest of the state in this definition is also reflected in Article 5 of the 2005 *Company Law*. As shown earlier, the Article states 'accept[ing] the supervision of the government and the general public' ahead of 'bear[ing] social responsibility' by corporations. In other words, companies should fulfil social responsibilities beyond those owed to the shareholders, but those responsibilities must operate within the frame of the state. Second, as further discussed in Chapter 8, despite the broad range of stakeholder interests encompassed in the Shenzhen Stock Exchange's definition of corporate social responsibility, those categories tend to coincide with the prevailing international and domestic pressures faced by the Chinese state in maintaining its current form of state-led economic development.

¹²⁴ 《环境保护法修正案（草案二次审议稿）》[Environmental Protection Law of the People's Republic of China (Draft Amendment for Second Deliberation by the Standing Committee of the National People's Congress) (People's Republic of China)Legislative Affairs Committee of the National People's Congress, 7 July 2013]<http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2013-07/17/content_1801189.htm>

¹²⁵ ACEF website<<http://www.acef.com.cn/about/introduction/index.shtml>>

¹²⁶ 《深圳证券交易所上市公司社会责任指引》[Guidelines on Social Responsibility of Companies Listed on the Shenzhen Stock Exchange] (People's Republic of China) Shenzhen Stock Exchange, 25 September 2006, art 2.

7.5 Conclusion

This chapter has examined the changes and continuities in China's post-2005 legal and regulatory reforms of investor and other stakeholder protection in listed SOEs. Taken together with those concerning state-manager relations discussed in Chapter 6, the two chapters illustrate the emergence of a new state-led stakeholder model in the regulation of corporate governance in listed SOEs.

This model may be distinguished from the Chinese pre-2005 state-led model in three main aspects. These are (1) increased state monitoring of SOE managers through both administrative and market-based means, (2) enhanced shareholder protection through both legal and regulatory mechanisms, and (3) expansion of other stakeholder protection that goes beyond the interests of the employees.

On the other hand, the central role played by the state in monitoring corporate managers, and mediating competing interests among different types of corporate actors, distinguishes this model from both the Anglo-American shareholder and the broader stakeholder approaches to corporate governance. As this chapter has demonstrated, few of the Chinese post-2005 legislative and regulatory changes have led to a transfer of the ultimate control of the state over those company relations to individuals or private sector organisations, due to various mechanisms in place within both corporate law and the judicial system. How might we interpret these changes and continuities in China's post-2005 regulation of the governance of listed SOEs from the perspective of state capitalism and institutional change? Chapter 8 addresses this question.

CHAPTER 8 INTERPRETING CHANGES AND CONTINUITIES IN CHINA'S POST-2005 REGULATION OF CORPORATE GOVERNANCE

8.1 Introduction

The foregoing two chapters have illustrated the emergence of a state-led stakeholder model of corporate governance in China through changes and continuities in its post-2005 regulation of the governance of listed state-owned enterprises (SOEs). This model has not been contemplated in the literature. As discussed in Chapter 2, three main analytical approaches, namely, agency theory of the firm-based analysis, path dependence analysis and the interest group politics approach, have been employed in existing studies on Chinese corporate governance. A popular assumption underlying each of these three approaches is that corporate governance in China is, or should be, progressing towards the standard Anglo-American outsider-based model presented by Hansmann and Kraakman.¹

How then, can we interpret the rise of this new state-led stakeholder model through those changes and continuities? As discussed in Chapter 3, national models of corporate governance are closely associated with their economic development models. Rather than maximising the interests of shareholders and other stakeholders, corporate governance in a state-led economy is often an instrument of the state to promote economic development through intervention in or coordinating with large businesses. This fundamental role of corporate governance led to a number of distinctive features in the governance of large companies in the former post-war state-led economies. Despite country-specific variations, these common features included close state-manager relations, the muted voice of minority shareholders and poor protection of stakeholders except employees.

However, this former state-led model has very limited application to state-led economies including China today. As Chapter 3 illustrated, the narrowly focused former state-led model cannot be isolated from the international and domestic environments in which that model operated. Internationally, as the trend of economic globalisation has accelerated only since the early 1990s, the former state-led model

¹ Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 449.

worked largely within the bounds of the nation state during much of the early post-war period, free from major outside pressures.² Domestically, the state-led stakeholder model was typically grounded in a corporatist state-society relationship characterised by a strong and centralised state and weak civil society, which allowed the state to forge close ties with large businesses while containing other societal groups whose short-term demands might not be consistent with the long-term economic-oriented goals of the state.³

Nevertheless, studies of comparative capitalism, including theory of the developmental state, have also suggested that state capitalism is not static. As discussed in Chapter 3, it intersects and interacts with major international and domestic forces for change. The intensification of these forces may eventually narrow the scope for state intervention in institutional change, including changes in the national system of corporate governance. Nevertheless, a strong and centralised state may utilise a variety of tools, such as limiting the contestability of the formulation and implementation of law or substituting the demand for law with extra-legal means,⁴ to enhance its coordinative capacity to maintain the state-led system, at least up to a certain point. The employment of these tools, as well as other tools, such as market forces, will inevitably lead to a degree of system hybridisation, but not necessarily a fundamental systemic change.

Drawing upon this frame of state capitalism and institutional change, this chapter will show that the rise of the state-led stakeholder model in the governance of Chinese listed SOEs post the 2005 corporate law reforms has not been a mere indication of China's greater embrace of any prevailing international corporate governance models. Rather, it has been driven by China's efforts to maintain the Chinese current form of state-led economic development, while grappling with the increasing demands made on the state for protection by investors and other stakeholders with economic globalisation and the pluralisation of interests within domestic society.

² Vivien Schmidt, *The Futures of European Capitalism* (Oxford University Press, 2002) 107-9; Vivien Schmidt, 'French Capitalism - Transformed, Yet Still a Third Variety of Capitalism' (2003) 32 *Economy and Society* 526, 530; Gregory Jackson and Richard Deeg, 'How Many Varieties of Capitalism? Comparing the Comparative Institutional Analyses of Capitalist Diversity' (MPIfG Discussion Paper No. 06/2, 11 April, 2006) 5 <<http://ssrn.com/abstract=896384>>.

³ Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton University Press, 1992) 27.

⁴ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) 31-39.

This chapter will proceed as follows. Section 8.2 outlines the international and domestic challenges faced by policy makers in China in maintaining the Chinese form of state-led economic development, and their response to those challenges at the broad policy level. Drawing upon, but extending, Milhaupt and Pistor's analysis of the sets of tools that can be used by the state to condition the interaction between legal and economic changes,⁵ section 8.3 explains the changes and continuities in Chinese post-2005 regulation of state-manager relations, and investor and other stakeholder protection from the perspective of state capitalism and institutional change. Section 8.4 concludes by summarising the main arguments of this chapter.

8.2 Challenges faced by the state in retaining state-led economic development

Economic globalisation and the pluralisation of interests within domestic society are some of the key challenges for all forms of state-led economies (as Chapter 3 discussed). China has faced unprecedented challenges in both aspects since the early 2000s. This is not only because of its rapid economic development and gradual integration into the world economy, but also the specific form of state capitalism engaged by Chinese leaders, that is, government ownership and control of large profit-seeking enterprises.

8.2.1 Economic globalisation

First, with China's gradual integration into the international community, it is no longer immune to economic globalisation and competition. China's WTO accession in 2001 had both benefits and costs. Overall, this event was viewed by Chinese policy makers as an instrument for furthering economic reform and development. The WTO membership not only meant potential growth in foreign trade and investment, but also the opportunity for Chinese enterprises, including SOEs, to improve efficiency through participating in international competition and exchanges.⁶

However, with WTO accession, the challenges faced by Chinese policy makers were imminent and multifaceted. On the one hand, China had to improve its market access through not only reducing trade barriers and opening important service sectors (such as

⁵ Ibid.

⁶ '中国改革开放进程中具有历史意义的一件大事---祝贺我国加入世界贸易组织' [Congratulations on Our Country's WTO Accession---a Historical Event in China's Reform and Opening up], *People's Net Editorial* (11 November 2001) <<http://www.people.com.cn/GB/123869/123883/15373/239174/17144126.html>>; Nicholas Lardy, *Integrating China into the Global Economy* (Brookings Institution Press, 2002) 20.

banking and finance industries) to foreign businesses, but also by altering the regulatory framework to meet international standards and practices.⁷ Indeed, as pointed out by Tomasic, the WTO commitments forced China to carry out an ongoing modernisation of its economic laws including company law and securities law.⁸ On the other hand, poor corporate governance of SOEs meant that they were ill-adapted to international competition, especially competition emanating from multinational corporations.⁹ Indeed, despite their surging accounting profits and international profile, the average efficiency of SOEs lagged behind Chinese private sector, let alone multinational corporations from the developed market economies. By the end of 2012, 54 of the central government-affiliated SOEs (central SOEs) had entered the list of the *Fortune* magazine World Top 500. However, a disproportionate share of the profits of SOEs was contributed by less than ten gigantic groups in state monopoly sectors such as petrochemical and telecommunications.¹⁰ The persistent lack of efficiency of the state sector has led many commentators to continue to attribute the improved overall financial position of the SOEs to their monopoly status and government policy supports.¹¹

8.2.2 Diversification of interests within society

Economic globalisation aside, the diversification of interests within Chinese society has become another challenge faced by Chinese policy makers to maintain state-led economic development. Similar to the former East Asian developmental states, the Chinese state-led model of economic development used to be supported by a corporatist type of state-society relationship, described by Frolic as a 'state-led civil society'.¹² China's economic reform and opening up over the past thirty years has seen considerable growth in the number of not-for-profit or non-governmental organisations,

⁷ Doug Guthrie, *China and the Globalisation* (Routledge, 2006) 300-1.

⁸ Roman Tomasic, 'Preface', in Roman Tomasic (ed), *Corporate Governance Challenges for China* (China Law Press, 2006) 1, 2; Also see Chao Xi, 'In Search of an Effective Monitoring Board Model: Board Reforms and the Political Economy of Corporate Law in China' (2006) 22 *Connecticut Journal of International Law* 1, 35-36.

⁹ Peter Nolan, *China and the Global Economy: National Champions, Industrial Policy, and the Big Business Revolution* (Palgrave Macmillan, 2001) 11.

¹⁰ The World Bank, *China 2030: Building a Modern, Harmonious, and Creative High-Income Society* (2012) 25 <<http://www.worldbank.org/cn/news/feature/2012/02/27/china-2030-executive-summary>>.

¹¹ Ibid; 何伟 [He Wei], '央企退出房地产是掩人耳目' [Central SOEs' Withdrawal from the Property Market-only a Sham] (2010) 13 改革内参 *Reform Internal Reference* 42 <http://www.caijing.com.cn/2010-05-18/110441517_1.html>; Wang Yong, 'Progress on SOEs Means Answering Political Questions' *Caixin Online* (22 May 2015) <<http://english.caixin.com/2013-05-22/100531336.html>>.

¹² B. Michael Frolic 'State-led Civil Society' in Timothy Brook and B. Michael Frolic (eds), *Civil Society in China* (M.E. Sharpe, 1997) 46, 56; Tony Saich, *Governance and Politics of China* (Palgrave Macmillan, 2nd ed, 2004) 228.

such as industrial and trade associations. However, as pointed out by Unger and Saich, unlike their counterparts in Western pluralist society, interest groups in China influence government policymaking mainly through retaining strong links with the government.¹³ This state-led state-society relationship, arguably, enabled the state to focus resources on the large SOEs relatively free of strong opposition from the private sector and general public.

This situation is, however, rapidly changing. Alongside globalisation and rapid domestic economic development, there has been a growing awareness among Chinese citizens of their self-interest, as well as a far greater desire to voice their opinions on every aspect of the social, economic and political life in China. In recent years, this trend has been particularly fuelled by the commercialisation of media and the arrival of the internet.¹⁴ Government censorship remains strong after the commercialisation of media. However, fierce competition for audiences has provided newspapers and internet websites with a strong incentive to 'break' news stories, despite risks of censorship penalties being imposed.¹⁵ In addition to the commercial press, internet social networks have become another important source for exposing scandals and expressing individual ideas. China had 384 million internet users and 145 million bloggers in 2010.¹⁶ As pointed out by Shirk, following decades of strict Communist Party (Party) control of media, the Chinese people have 'a voracious appetite for news'.¹⁷

One important aspect of this trend towards pluralisation of interests has been a much stronger voice from public investors on the Chinese stock market. These investors were largely a silent group in the early years of market development, when a fast growing economy and limited avenues for private investment fuelled a generally booming stock market. However, as the bearish market has become more of a norm than exception since the early 2000s (due, in part, to the frequent exposure of corporate scandals and other forms of market abuses, and in part to increased liquidity pressures on the market

¹³ Jonathan Unger, 'Chinese Association, Civil Society, and State Corporatism: Disputed Terrain', In Jonathan Unger (ed), *Associations and the Chinese state: Contested Spaces* (M.E. Sharpe, 2008) 1; Tony Saich, *Governance and Politics of China* (Palgrave Macmillan, 2nd ed, 2004) 226-32.

¹⁴ Susan Shirk, *Changing Media, Changing China* (Oxford University Press, 2010) 2; Zi Xue Tai, *The Internet in China: Cyberspace and Civil Society* (Routledge, 2006); Christopher R. Hughes and Gudrun Wacker (ed), *China and the Internet: Politics of the Digital Leap Forward* (Taylor & Francis Group, 2003).

¹⁵ Shirk, above n 14.

¹⁶ China Internet Network Information Centre, the 25th Statistical Report on the Development of China's Internet (January 2010) <<http://www.cnnic.net.cn/uploadfiles/pdf/201015/1/15/101600.pdf>>.

¹⁷ Shirk, above n 14.

following the 'split share structure reform'),¹⁸ poor investor protection in listed companies has attracted fierce criticisms from the public.¹⁹ The lack of investor confidence has no doubt exacerbated the dismal prospect of the stock market in China as an important source of equity financing for SOEs.

Nevertheless, increased diversification of interests within society is not only reflected in the growing dissatisfaction of public investors. Mounting social tensions have posed further challenges to the policy makers in maintaining the Chinese form of state-led development. These tensions are generally interpreted as a side effect of the Chinese development-first approach adopted since the late 1970s.²⁰ The approach has produced near double digit economic growth for over thirty consecutive years. It is, however, at the expense of rapidly widening wealth gaps in urban and rural areas, serious environmental pollution and corruption. Taking the widening wealth gaps for example, the Gini index (or Gini ratio) has been widely used as a measure of inequality in national income distribution. Analysts suggest that a Gini coefficient of 0.4 on a zero to one scale indicates significant income inequality. China's Gini coefficient reached 0.47 in 2005 from 0.412 in 2000,²¹ approaching the levels of Nigeria and Brazil. Both these countries are well known for their wealth disparity.²² Increasing public unrests caused by these problems have further led to a sharp increase in government expenditures on social management over the past few years.²³

¹⁸ Yuwa Wei, 'China's Capital Market and Corporate Governance: the Promotion of the External Governance Mechanism' (2007) 4 *Macquarie Journal of Business Law* 325, 337; Jenny Fu, 'Corporate governance of listed companies in China: between State-owned Corporate Groups and Public Investors' (2006) 19 *Australian Journal of Corporate Law* 114, 128

¹⁹ For example, widespread illegal activities in the Chinese stock market led Wu Jinglian to describe China's stock market as 'worse than a casino'. See 吴敬琏 [Wu Jinglian], 《十年纷纭话股市》 [Ten Years of the Stock Market] (上海远东出版社 [Shanghai Far East Publishing House], 2001) 8-9.

²⁰ Wen Jiabao, Government Work Report delivered during at the Third Plenum of the 11th National People's Congress (March 5, 2010) <http://www.chinadaily.com.cn/china/2010npc/2010-03/05/content_9541766.htm>.

²¹ These figures are estimates of the United Nations and the Chinese Academy of Social Science. *Caixin Magazine*, a highly regarded financial media in China, suggested that Chinese government did not release any official Gini ratio figures from 2001 to 2011, claiming that it was too difficult to calculate due to incomplete data on high income groups. See Fang Xuyan and Lea Yu, 'Gov't Refuses to Release Gini Coefficient' *Caixin* (online), 18 January 2012 <english.caixin.com/2012-01-18/100349814.html>.

²² Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (Cambridge University Press, 2008) 256; 'Inequality: Gini out of the Bottle', *The Economist* (online), 26 January 2013 <www.economist.com/news/china/21570749-gini-out-bottle>.

²³ Ai Guo Han, 'Building a Harmonious Society and Achieving Individual Harmony' (2008) 13 *Journal of Chinese Political Science* 143, 144-8; Angang Hu, *Economic and Social Transformation in China: Challenges and Opportunities* (Routledge, 2007) 226; Chih-Jou Jay Chen, 'Growing Social Unrest in China: Rising Social Discontents and Popular Protests' in Guoguang Wu and Helen Lansdowne (eds), *Socialist China, Capitalist China: Social Tension and Political Adaptation under Economic Globalisation* (Routledge, 2009) 10; Tan Kong Yam, 'China's 11th Five-Year Plan: A Critical Perspective', in John Wong and Wei Liu (eds), *China's Surging Economy: Adjusting for More Balanced Development* (World Scientific, 2007) 253.

The increasingly wealthy and politically powerful SOEs have often been at the centre of these social tensions.²⁴ Despite significant contribution to tax revenue, the extent of their contribution to the life of ordinary citizens, the ultimate owners of state-owned assets vested in these large enterprises,²⁵ has been widely questioned.²⁶ This is exacerbated by the frequent exposure of various forms of extravagance and corruption involving these privileged corporate groups and their managers. With the growth of online media and social networks, any item of negative information concerning SOEs (such as lavish monopoly profits, excessive executive remuneration, and environmental pollution incidents) often spreads quickly, generating significant public resentment towards not only the enterprises concerned, but also central and local governments as their dominant shareholders. Indeed, these controversies surrounding central SOEs have led Li Rongrong, former Director of the State-owned Assets Supervision and Administration Commission (SASAC), to express his well-known dilemma in the following way, 'I was criticised when these SOEs were making losses. Now they are making profits, I am still criticised'.²⁷

While maintaining state control of large SOEs, the Party responded to the growing social and environmental tensions in China by outlining a vision to build a 'harmonious society' through adopting a 'scientific approach to development'.²⁸ 'Harmonious society' has been defined as a 'people-centred' approach based on 'the rule of law, equity, justice, sincerity, amity and vitality'.²⁹ 'Scientific development' emphasises coordinated development of the economy, society and natural environment.³⁰ First

²⁴ 卢福才 [Lu Fucui] (ed), 《中央企业公司治理报告》 [Report on Corporate Governance of Central State-owned Enterprises] (中国经济出版社 [China Economic Publishing House], 2011) 2

²⁵ 《中华人民共和国企业国有资产法》 [The Enterprise State-owned Assets Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 28 October 2008, art 3.

²⁶ Wang Yong, above n 11.

²⁷ '李荣融: 想不明白为啥国企好不好我都要挨骂' [Li Rongrong: I am Always Blamed, Whether SOEs are Making Profits or Not], *Xinhua Net News Story* (12 December 2009) <http://news.xinhuanet.com/fortune/2009-12/12/content_12634915.htm>.

²⁸ 《中共中央关于加强党的执政能力建设的决定》 [Decision of the Central Committee of the Chinese Communist Party on Strengthening the Governing Capacity of the Party], Adopted at the Fourth Plenum of the 16th Congress of the Chinese Communist Party, 19 September 2004 ('*Decision on Strengthening Party Governing Capacity*'); 《中共中央关于构建社会主义和谐社会若干重大问题的决定》 [Decision of the Central Committee of the Chinese Communist Party on Several Important Issues Concerning the Establishment of a Socialist Harmonious Society], Adopted at the Sixth Plenum of the 16th Central Committee of the Chinese Communist Party, 11 October 2006 ('*Decision on Establishment of a Harmonious Society*').

²⁹ 'Building Harmonious Society Crucial for China's Progress', *People's Net News Story* (27 June 2005) <http://english.people.com.cn/200506/27/eng20050627_192495.html>.

³⁰ *Decision on Establishment of a Harmonious Society*, above n 28.

introduced by former President Hu Jintao in 2004,³¹ the concepts of 'harmonious society' and 'scientific development' have since become the Party's guiding principles in directing all aspects of socioeconomic life in China.³² As discussed next, these principles have also formed a key policy foundation for China's post-2005 regulation of corporate governance, including corporate social responsibility. While bearing the imprints of international and domestic pressures for change, the rise of the state-led stakeholder model of corporate governance in China resonates with the Party-state's response to those pressures at the policy level.

8.3 How can we interpret the changes and continuities in China's post-2005 regulation of corporate governance?

In state-led economies, the fundamental role of corporate governance is to facilitate economic-oriented goals of the state. In that sense, the state-led stakeholder model of corporate governance that has emerged in China is still conforming to the former state-led model. As discussed in the previous two chapters, China has adopted many market and non-market-based legal and regulatory changes post-2005, in an effort to improve monitoring of managers, and strengthen the protection of investors and other non-shareholder stakeholders. However, none of these changes, as shown below, has been an end in itself. Put together, they form an integral part of the policy tools of the state to promote economic development and the symbiotic social stability, amid rapidly changing international and domestic dynamics.

From the perspective of state capitalism and institutional change, these changes and continuities in China's post-2005 regulation of corporate governance present an alternative path for the evolution of state-led corporate governance. Faced with strong international and domestic forces for change, rather than converging into any of the prevailing international models of corporate governance (including the Anglo-American outsider-based model), the former state-led model may evolve into a hybrid state-led stakeholder approach, by readjusting its relations with key corporate actors, as well as taking into account other emerging interests, without necessarily relinquishing state control.

³¹ *Decision on Strengthening Party Governing Capacity*, above n 28.

³² Li-Wen Lin, 'Corporate Social Responsibility in China: Window Dressing or Structural Change?' 2010 (28) *Berkeley Journal of International Law* 64, 88

In this regard, China's shift in the approach to corporate governance post-2005 also provides a ready example of the variety of tools that may be used by a centralised state to resist a fundamental systemic transformation.³³ First, state limitation of the contestability of the law is one set of such tools identified by Milhaupt and Pistor.³⁴ As discussed in Chapter 3, this set of tools can be utilised in not only the formulation but also the implementation of law. The employment of this set of tools in both processes has been manifested in China's post-2005 regulation of investor and other stakeholder protection. As Chapter 7 demonstrated, the various legal and regulatory reforms in these two areas have not resulted in a transfer of state control over those two sets of company relations to non-state sectors such as individuals and or civil society organisations. On the one hand, most of the improved rules in those two areas have been formulated by the state without significant input from non-governmental organisations. On the other hand, while increased regulation may lead to better protection, the extent to which those rules can be taken up by minority shareholders and other stakeholders to exert a strong voice about corporate affairs remains rather limited. Significant obstacles exist both within the system of corporate law and the judicial system, to hold shareholder and stakeholder activism, especially organised activism, against their companies (and the state) in check.

Non-legal substitutes for law (as the second set of tools identified by Milhaupt and Pistor³⁵) have also been extensively utilised in China's post-2005 reforms of corporate governance. As shown in Chapters 6 and 7, many extra-legal means, such as the system of 'Party management of cadres', numerous Party policy statements and administrative guidelines have operated alongside formal regulation. While providing, arguably, a cheaper means to address various problems with listed SOEs, these non-legal means also help to preserve the dominance of the state over company relations. As discussed in Chapter 3, for effective state-business collaboration to take place, the state bureaucracies need to have sufficient flexibility supported by broadly-drafted laws. Indeed, as the case study on the 2008 China tainted milk scandal in Chapter 9 will suggest, many other administrative, and often *ad hoc* means, have also been utilised by the Chinese state to substitute demand for law from private actors, as well as to maintain the discretionary power of the state.

³³ Milhaupt and Pistor, above n 4.

³⁴ Ibid 7.

³⁵ Ibid 38-39.

However, as argued in Chapter 3, focusing on these traditional instruments of an interventionist state, Milhaupt and Pistor seemed to have overlooked one other set of tools that may be utilised by the state to increase its coordinating capacity. This is to be found in market forces, including principles and structures of corporate governance in developed market economies and international best practices. Indeed, as discussed in Chapter 2, the flexible adaptability of the state through combining state power with market forces is one of the important features of the Chinese form of state capitalism. Two main purposes can be deduced from the adoption of these forces by policy makers in China's post-2005 regulation of corporate governance. The first is to strengthen the effectiveness of state control over corporate managers, and the second, to improve the coordinating capacity of the state to maintain a pro-growth environment through mitigating the conflicts between companies and their minority shareholders and other non-shareholder stakeholders.

In relation to the first purpose, as discussed in Chapter 6, viewed in isolation, the various market-based changes in the Chinese post-2005 reforms of state-manager relations within listed SOEs appear to indicate China's greater embrace of the Anglo-American outsider-based corporate governance. However, taken together with other non-market-oriented changes, and persistent state control in corporate decision-making, the various market-based changes can be seen as tools to improve the efficiency, and hence international competitiveness, of SOEs without necessarily removing state control. Indeed, this pragmatic approach has been summarised by Li Rongrong, former Director of SASAC, in the following way:

We will actively foster and develop a group of large corporations and enterprise groups of international competitiveness among central SOEs. We will support qualified large and medium-sized SOEs through restructuring, going public, entering into partnership with foreign enterprises and various other ways to accelerate the development of major businesses so as to enhance their influence and driving power.³⁶

The rapid growth of Chinese state-owned investment overseas in recent years has generated a heated debate about whether Chinese SOEs are commercially-oriented enterprises or instruments of the state.³⁷ The flexible adaptability of the Party-state in

³⁶ Li Rongrong, 'Continuously Adjusting the Layout and Structure of China's State Economy, Propelling Chinese SOEs to Participate in International Competition and Cooperation' (Keynote Speech delivered at the International Merger & Acquisition Summit Beijing 2003, 19 November 2003) <<http://www.sasac.gov.cn/n2963340/n2964712/3049656.html>>.

³⁷ Many issues in this area were canvassed by participants of the Australia-China Investment Relations Conference held in University of Canberra, 30 and 31 July 2012.

China's post-2005 regulation of state-manager relations appears to suggest that they can be both. This is because, the Party-state itself has taken on a more market-oriented aspect in pursuing policy goals.

Viewed in this light, China's recent efforts in strengthening investor and other stakeholder protection have served a similar objective. Where 'investor protection' and 'corporate social responsibility' have become widely championed by investors of the globalised market, it is desirable to equip Chinese companies with the same or similar set of concepts and norms. Indeed, this mentality is manifested in the *Guiding Opinion on the Implementation of Corporate Social Responsibility by Central-government Affiliated SOEs* ('*Guiding Opinion*')³⁸ issued by SASAC. Outlining the content of corporate social responsibility and the strategies for how to fulfil it (as discussed in Chapter 7), the *Guiding Opinion* states that strengthening corporate social responsibility will help central SOEs to achieve sustainable development by enhancing innovation, transforming patterns of growth, improving corporate branding and image, and the quality of employees and corporate cohesion. Furthermore, compliance with corporate social responsibility by central SOEs will help them to 'participate in international economic exchange and cooperation'.³⁹

Second, further to an instrument to improve the international competitiveness of listed SOEs, China's strengthening of investor and other stakeholder protection post-2005 can be seen as policy tools to increase the coordinative capacity of the state to maintain a pro-growth environment through alleviating social tensions surrounding listed companies. This is especially so with the greater propensity for the state to be implicated in these tensions due to state ownership of enterprises.

On the one hand, globalisation of markets aside, increased legal protection of shareholders in China post-2005 has been driven by an urgent need to restore investor confidence in the domestic stock market. As noted in Chapter 6, this intention has been best manifested in the *Explanation of the Draft Amendment to the Company Law*⁴⁰

³⁸ 《关于中央企业履行社会责任的指导意见》 [Guiding Opinion on the Implementation of Corporate Social Responsibility by Central Government-affiliated SOEs] (People's Republic of China) State-owned Assets Supervision and Administration Commission, 29 December 2007 ('*Guiding Opinion on Corporate Social Responsibility*').

³⁹ Ibid.

⁴⁰ 曹清泰 [Cao Qingtai], '关于《中华人民共和国公司法》(修订草案)的说明' [Explanation of the Draft Amendment to the Company Law of the People's Republic of China] (Delivered at the 14th Meeting of the 10th National People's Congress Standing Committee, 25 February 2005) <http://www.npc.gov.cn/wxzl/gongbao/2005-10/27/content_5343120.htm>.

produced by the Legal Affairs Office of the State Council. In the *Explanation*, a State Council document⁴¹ calling for fostering steady development of the stock market through multiple means, including strengthening corporate governance, was cited alongside widespread public concern for poor investor protection in Chinese listed companies.⁴² Indeed, as discussed in Chapter 7, most of the investor protection-oriented rules adopted in China post-2005 have been to improve investor confidence in the stock market through addressing the various problems faced by them under the pre-2005 regulatory framework. Since a bearish stock market has become more of a norm since the 2000s, strengthening investor protection is likely to continue to dictate the reform agendas of Chinese stock market regulators, such as the China Securities Regulatory Commission (CSRC) and the stock exchanges.

On the other hand, China's increasing mandating of corporate social responsibility post-2005 is in line with the Party-state's response to growing social and environmental tensions at the broad policy level. As noted earlier, the interests of minority shareholders, no matter how important, are not the only source of domestic pressures for change faced by Chinese policy makers. As the establishment of a 'harmonious society' through 'scientific development' became the Party's chief policy response to mounting social and environmental tensions, this policy has also underpinned most corporate social responsibility-related policy statements and guidelines issued by various government or semi-government agencies. For example, the *Guiding Opinion* issued by SASAC is explicitly aimed to 'comprehensively implement the spirit of the 17th CCP National Congress and the theory of Scientific Development', and to give central SOEs the impetus to fulfil corporate social responsibilities 'so as to realise coordinated and sustainable development of enterprises, society and environment in all respects'.⁴³ To implement 'scientific development' is also specified in the regulatory aims of the corporate social responsibility guidelines issued by the Shenzhen and the Shanghai Stock Exchanges.⁴⁴

⁴¹ 《国务院关于推进资本市场改革开放和稳定发展的若干意见》 [Some Opinions of the State Council on Promoting the Reform, Opening and Steady Growth of Capital Markets] (People's Republic of China) State Council, 31 January 2004.

⁴² 曹清泰 [Cao Qingtai], above n 40.

⁴³ *Guiding Opinion on Corporate Social Responsibility*, above n 38, art 19.

⁴⁴ 《深圳证券交易所上市公司社会责任指引》 [Guidelines on Social Responsibility of Companies Listed on the Shenzhen Stock Exchange] (People's Republic of China) Shenzhen Stock Exchange, 25 September 2006 ('Shenzhen Stock Exchange Guidelines on Corporate Social Responsibility'). 《关于加强上市公司社会责任承担工作暨发布〈上海证券交易所上市公司环境信息披露指引〉的通知》 [Notice on Strengthening Listed

Indeed, the Party-state's response to increasing social pressures at the policy level has influenced the definition of corporate social responsibility in China. As noted in Chapter 7, despite the broad range of stakeholder interests captured in the definition offered by the Shenzhen Stock Exchange,⁴⁵ those categories tend to coincide with the prevailing domestic and international pressures faced by the Party-state in maintaining the Chinese economic development model. On the one hand, the inclusion of the shareholders in the definition seems to be outside the scope of corporate social responsibility for most other comparators. This is, however, consistent with strong public concern for poor investor protection on the Chinese stock market. Indeed, as these domestic and international pressures continue to grow, further response has been made by the new Chinese leaders. In addition to strengthening investor protection and corporate social responsibility, SOEs are required to increase the share of profits paid to public finance to 30 per cent (from current five to 15 per cent) by 2020, which will be used to 'ensure and improve the livelihood of the people'.⁴⁶ On the other hand, other issues such as human rights and gender equality, which are often discussed in the context of the Western concept of corporate social responsibility, are not included in the definition.⁴⁷

8.4 Conclusion

This chapter has interpreted the changes and continuities in China's post-2005 regulation of corporate governance of listed SOEs from the perspective of state capitalism and institutional change. The regulatory framework has given rise to a new hybrid state-led stakeholder model of corporate governance which is not contemplated in existing literature.

From the perspective of state capitalism and institutional change, this chapter has shown that the rise of this new approach to the governance of listed SOEs cannot be separated from China's efforts to maintain its state-led economic development amid international and domestic pressures for change, particularly economic globalisation and the

Companies' Assumption of Social Responsibility and the Release of the Shanghai Stock Exchange Guidelines on Disclosure of Environmental Information by Listed Companies] (People's Republic of China) Shanghai Stock Exchange, 14 May 2008.

⁴⁵ *Shenzhen Stock Exchange Guidelines on Corporate Social Responsibility*, above n 44, art 2.

⁴⁶ 《中共中央关于全面深化改革若干重大问题的决定》 [Decision on Several Major Issues Concerning Comprehensively Deepening Reforms], adopted at the Third Plenum of the 18th Central Committee of the Chinese Communist Party, 12 November 2013; Yao Jing, 'More SOEs to be Going Private: Official' *People's Net News Story* (20 December 2013) <<http://english.people.com.cn/business/8490679.html>>.

⁴⁷ Lin, above n 32, 66

diversification of interests within Chinese society. In the Chinese form of state capitalism, these pressures have been particularly exacerbated by state ownership of large companies. These complex and dynamic pressures have led to extensive changes in China's post-2005 regulation of three sets of company relations central to the former state-led model of corporate governance. Yet, a paramount objective of retaining control over large listed SOEs (as the Chief economic foundation of the Chinese form of state capitalism) has led the Party-state to adopt several sets of tools to increase its coordinating capacity, as well as to refract pressures from shareholders and other non-shareholder stakeholders, including the wider society, for a more fundamental systemic change. As this chapter discussed, largely overlooked by Milhaupt and Pistor, one particular set of tools employed by Chinese policy makers has been corporate governance mechanisms from the Anglo-American developed market economies and international best practices.

To what extent has the rise of this state-led stakeholder model influenced the reality of corporate governance in listed Chinese SOEs post the 2005 corporate law reforms? Chapter 9 examines the changes and continuities in the governance practice in these companies post-2005, and explores some of the reasons behind them.

CHAPTER 9 CHANGES AND CONTINUITIES IN THE GOVERNANCE PRACTICES IN LISTED SOES POST-2005

9.1 Introduction

This thesis has so far analysed the evolution of regulation of corporate governance in state-controlled listed companies in China from the former state-led to its current state-led stakeholder model. This chapter considers to what extent this shift has been reflected in the reality of corporate governance within these large companies. Many factors may have contributed to the changes, or the lack thereof, in the latter respect. In exploring some of the reasons behind them, this chapter will focus on the role of the state which remains at the core of this new state-led model. In doing so, this chapter helps to illuminate the relative advantages and disadvantages of this model.

The main argument of this chapter is that the state-led stakeholder model has both advantages and disadvantages. While its strong capacity to facilitate economic development and social stability is evident, there are some inherent dangers associated with overreliance on the state as essentially the sole guardian of this model. As discussed below, these dangers, or disadvantages, of the state-led stakeholder model have contributed to the lack of substantial changes in the reality of Chinese corporate governance post-2005. Despite extensive legal and regulatory reforms over the past few years, the various governance problems associated with listed SOEs prior to the 2005 corporate law reforms, including insider control of companies by managers and controlling shareholders, poor protection of investors and non-employee stakeholders, have continued to various extents. Hence, despite the significant policy goals it serves, the long term viability of this model is likely to hinge on the balance between the will and capacity of the state in coordinating and adjusting diverse interests within listed state-owned enterprises (SOEs) and the risk of lax internal controls that persists at the corporate level.

This chapter is divided into four sections. Section 9.2 discusses the governance practices in Chinese listed SOEs post-2005 by drawing upon several recent studies. To provide some further insights into this area, section 9.3 conducts a case study of the central and local governments' involvement in the lead up to and the aftermath of the 2008 melamine-tainted milk scandal. As discussed in Chapter 1, a case study of the milk scandal is appropriate for this purpose for a number of reasons. Firstly, although a

single case study often runs the risk of being unrepresentative, the scandal provides us with rare insights into state involvement in corporate governance within a particular Chinese industry. Secondly, due to its large scale and profound social, economic and political implications, the scandal provides a remarkable platform to examine the interaction of state power and forces of globalisation and the diversification of interests within Chinese society at corporate level. Finally, as Milhaupt and Pistor pointed out, although a corporate scandal may not be representative of the everyday governance practices in listed SOEs, it may better expose the features and weaknesses of corporate governance than when the company functions smoothly.¹

Drawing upon Chinese central and local governments' involvement in corporate affairs as reflected in the milk scandal, as well as Ho's analysis of state-led corporate social responsibility,² section 9.4 explores in what ways the state-led stakeholder model of corporate governance may have contributed to the lack of more significant changes in the reality of corporate governance post-2005. Section 9.5 concludes by highlighting the main argument of this chapter.

9.2 Changes and continuities in the governance practices in listed SOEs post-2005

At the outset, it should be noted that listed SOEs in China have been seen as making steady progress in corporate governance in several evaluation reports produced by Chinese mainland and Hong Kong researchers. However, as discussed below, these reports should be received with some caution.

First, the Centre for Corporate Governance of the China Academy of Social Science (CASS) (later joined by the international business consulting firm Protiviti) has conducted an annual assessment of corporate governance in Chinese top 100 listed companies, ranked by market capitalisation, since 2005 (the *CASS Studies*). The *CASS Studies* are led by Professor Lu Tong.³ As noted in Chapter 2, most of these companies are controlled by central or local governments. In line with the *OECD Principles of*

¹ Curtis Milhaupt and Katharina Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) 10-11.

² Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375.

³ Protiviti and China Academy of Social Science (CASS), 《2012 Assessment Report of Corporate Governance of Top 100 Chinese Listed Companies》 [2012 中国上市公司一百强治理评价报告] 2 <<http://www.protiviti.com/zh-CN/Pages/zh-CN-Corporate-Governance-Assessment-Summary-Report-on-the-Top-100-Chinese-Listed-Companies.aspx>>.

Corporate Governance,⁴ the *CASS Studies* evaluate governance performance of the Chinese top 100 in six areas. These are: shareholders rights, equitable treatment of shareholders, roles of stakeholders, information disclosure and transparency, responsibilities of the board of directors and responsibilities of the board of supervisors.⁵ In doing so, the *CASS Studies* developed a complex index comprising about 80 assessment indicators/questions concerning each of these governance areas. A numerical score was assigned to each indicator, with a total of 100 points.⁶

As the composite diagram in Appendix 9-1 shows, the *CASS Studies* suggest a general trend of improvement in the governance of China's top 100 from 2005 to 2011.⁷ This improvement is most evident in the areas of shareholders' rights, roles of stakeholders and information disclosure and transparency. This is despite the average scores for most of the governance areas remaining quite low. At the end of 2011, four out of the six governance areas mentioned above, except equitable treatment of shareholders and information disclosure and transparency, scored between 50 and 60 points.⁸

Similar results have been reported by researchers of the Hong Kong Baptist University in their 2012 evaluation of corporate governance in 121 listed companies from four major Hong Kong stock indexes, including the Hang Seng Index (the *Hong Kong Listed Companies Report*).⁹ Using a methodology similar to the *CASS Studies*, the *Hong Kong Listed Companies Report* suggested significant improvements made by Hong Kong-listed mainland SOEs in their corporate governance practice over the past few years. According to the *Report*, six mainland companies, five of which controlled by the central government, ranked among the top 10 Hong Kong-listed companies with best

⁴ *OECD Principles of Corporate Governance* (2004 edition). The OECD Principles of Corporate Governance cover five areas: The rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency and the responsibilities of the board.

⁵ Protiviti and CASS, above n 3, 4.

⁶ *Ibid.* For example, in relation to the responsibilities of the board of directors, the CASS Studies adopted over 20 indicators concerning four areas, namely, the operations of the board, conflicts of interests, board composition and directors training.

⁷ *Ibid.* 28.

⁸ *Ibid.* 7.

⁹ The other stock indexes are HK Large Cap Index, Hang Seng China-Affiliated Corporation Index and Hang Seng China Enterprise Index. See Hong Kong Institute of Directors and Hong Kong Baptist University, *Report on the HKLoD Corporate Governance Score-card 2012* (The Hong Kong Institute of Directors, 2012), Forward.

corporate governance performance in 2011.¹⁰ This can be contrasted with the bottom ranking of most mainland companies on a similar list in 2003.¹¹

Recent development in corporate social responsibility in the Chinese top 100 SOEs has also received some positive appraisal. The Corporate Social Responsibility Centre of CASS released its *2012 Report on Corporate Social Responsibility of Chinese Enterprises*.¹² In addition to a general trend of improvement, the *Report* found that the top 100 SOEs outperformed their counterparts in the private sector and the top 100 foreign enterprises in China. This was attributed by the authors to the more stringent government regulation imposed on SOEs in this area.¹³ Nevertheless, the 40.9 per cent average score received by the top 100 SOEs for their corporate social responsibility performance in 2011 was quite low.¹⁴

Such evaluation reports on Chinese corporate governance should always be treated with some caution. First, rather than empirical work, these studies were mainly based on publicly available information, primarily, company reports. For example, the main data sources for the *CASS Studies* are company annual reports, company constitutions, websites, and websites of Chinese stock exchanges.¹⁵ These studies therefore only assess the self-reported governance practice of these companies, which may or may not be in accordance with their real governance practice. This is particularly so with the widespread overemphasis of form than substance in corporate reporting in China.¹⁶

Second, the assessment indicators relied upon by the *CASS Studies* and *Hong Kong Listed Companies Report* may be problematic. The *OECD Principles of Corporate Governance* were based on the work of US and UK corporate governance advocates

¹⁰ Ibid 9. The six companies are Bank of China, China COSCO, China Life, CNOOC, ICBC and Lenovo Group.

¹¹ Toh Han Shih, 'Corporate Governance of Hong Kong Firms Better Now, Survey Found', *South China Morning Post* (online) (21 Nov 2012) <<http://www.scmp.com/business/companies/article/1086984/corporate-governance-hong-kong-firms-better-now-survey-found>>.

¹² 陈佳贵等 [Chen Jiagui et al], 《中国企业社会责任研究报告 (2012)》 [Research Report on Corporate Social Responsibility Report of China (2012)] (社会科学文献出版社 [Social Sciences Academic Press], 2012); Also see 许家林, 刘海英 [Xu Jialin and Liu Haiying], 《我国央企社会责任信息披露现状研究基于 2006~2010 年间 100 份社会责任报告的分析》 [Corporate Social Responsibility Disclosure of Central SOEs: Evidence from 100 CSR Reports Released between 2006 and 2010] (2010) 6 中南财经政法大学学报 *Journal of Zhongnan University of Economics and Law* 77, 84.

¹³ 陈佳贵等 [Chen Jiagui et al], above n 12, 20-23.

¹⁴ Ibid 31.

¹⁵ Protiviti and CASS, above n 3, 4.

¹⁶ Shanghai Stock Exchange Research Institute, 中国公司治理报告: 透明度与信息披露 [Chinese Companies Corporate Governance Report: Transparency and Information Disclosure] 复旦大学出版社 ([Fu Dan University Press], 2008) 48.

and international investor groups, and have been widely considered as reflecting governance practices in the Anglo-American large widely-held companies. These companies are of 'a different kind of corporate entity to China's state controlled and largely state owned listed companies'.¹⁷ Therefore, the various indicators utilised in the above evaluation reports which are based on the *OECD Principles*, may not capture some governance mechanisms distinctive to Chinese companies, nevertheless having a crucial bearing on their governance practice. For example, neither the *CASS Studies* nor the *Hong Kong Listed Companies Report* contains any indicator to assess the role of the Chinese Communist Party (the Party) and the Chairman of the board of directors, two most important actors in the governance of listed SOEs.

Indeed, also based on the analysis of company annual reports and other publicly available information (but with greater attention paid to the unique corporate governance practices in China), some other studies have found more limited changes in the reality of corporate governance in listed SOEs post-2005. For example, in a case study of corporate governance in the first nine Chinese mainland companies listed in Hong Kong, De Jonge found that overseas listing has not resulted in any dramatic changes in the day-to-day governance practice in these companies. As the author concluded, 'what these case studies most obviously reveal is the pervasive influence of the state in almost every aspect of business decision-making over the 12 years since the nine firms were listed'.¹⁸

A 2011 report on corporate governance in 109 listed companies controlled by central SOEs produced by Lu Fucai and his colleagues (the *Listed Central SOEs Report*) further highlights various problems with large listed SOEs.¹⁹ For example, the *Listed Central SOEs Report* suggested that abuse of insider control by top corporate executives, a typical governance problem in listed SOEs prior to the 2005 corporate law reforms, has continued to exist. According to the authors, this has been manifested in the widespread existence of executive grey income, reckless business expansion and diversification, and various forms of 'on the job consumption' by SOE leaders that 'has

¹⁷ Roman Tomasic, 'Looking at Corporate Governance in China's Large Companies: Is the Glass Half Full or Half Empty?' in Guanghua Yu (ed) *The Development of the Chinese Legal System Change and Challenges* (Routledge, 2010) 182, 195.

¹⁸ Alice De Jonge, *Corporate Governance and China's H-Share Market* (Edward Elgar, 2008) 7.

¹⁹ 卢福才 [Lu Fucai] (ed), 《中央企业公司治理报告》 [Report on Corporate Governance of Central State-owned Enterprises] (China Economic Publishing House, 2011).

sometimes reached an uncontrollable state'.²⁰ The weak internal control in listed central SOEs has, in part, been caused by the persistent high level of comingling of senior executives in listed companies and their state-owned parent companies. In the 109 listed companies studied by Lu Fucai and his colleagues, 80 per cent of the Chairmen's roles were held by senior executives of the companies' state-owned parents.²¹ In addition, 35 per cent of other non-independent directors in these companies coincided with senior executives in their state-owned parents. As Appendix 9-2 suggests, this phenomenon of overlapping senior executives in the listed companies and their state-controlled parents is even more prevalent in China's top 15 financial and non-financial listed companies.

Other problems suggested by the *Listed Central SOEs Report* include poor protection of minority shareholders and the lack of substance in the corporate social responsibility reports issued by listed central SOEs. In relation to the poor protection of minority shareholders, the authors noted that, due in part to the increased regulation and intervention from the State-owned Assets Supervision and Administration Commission (SASAC), exploitation of minority shareholders by controlling shareholders through outright stripping of listed companies' assets has significantly reduced. However, diversion of company funds through indirect means, such as related party transactions, remains fairly common.²² This has been, in part, reflected in the lack of detailed disclosure of related party transactions, particularly the relevant pricing mechanisms and payment methods, in many listed SOE's annual reports.²³

In relation to corporate social responsibility, the *Listed Central SOEs Report* found that despite the rapid increase in the number and volume of corporate social responsibility reports issued by listed central SOEs, their real improvement in this area is

²⁰ Ibid 121.

²¹ Ibid 55.

²² Ibid 43, 84. Illegal diversion of listed companies' funds was found by Lu Fucai and his colleagues to have occurred to 27 per cent of the controlling shareholders. Sixty-three per cent of the 109 listed companies controlled by central SOEs had related party transactions with their controlling shareholders. Trading contracts accounted for the largest percentage of the total number of these transactions (30.21 per cent). Provision of guarantee by listed SOEs for their controlling shareholders or other group companies accounted for 66.87 per cent of the total amount involved in the transactions.

²³ Ibid 114-6.

questionable. This is because most companies have apparently treated these reports as promotional documents, and disclosed little negative information in them.²⁴

Concerning corporate governance practice in central SOEs, the audit reports of the China National Audit Office (NAO) provide another valuable source of information. The NAO conducts annual audit of selected central SOEs including their listed subsidiaries. In June 2012, the NAO released its audit results of the financial revenues and expenditures of 15 major central SOEs, including China National Petroleum Corporation (CNPC, parent company of PetroChina), China Petrochemical Corporation (Sinopec Group, parent of Sinopec Corporation) and Sinosteel Corporation. All 15 companies were found to have 'problems of lack of standardisation and stringency' in financial management and internal controls.²⁵ As a result of the 2012 audits, 83 officials from these companies were charged with various offences including overstating profits and illegal distribution of off-the-book income.²⁶

In May 2013, the NAO released its audit results on another 13 central SOEs, including ten controlled by SASAC and three state-controlled banks.²⁷ The NAO noted some moderate improvement in corporate governance within some of these companies. However, many of the problems suggested in the 2012 audits remained. These include understating or overstating of earnings, misapplication of company funds, failure to invite bids for major company contracts and projects, tax evasion and excessive staff benefits and bonuses.²⁸ For example, China Mobile was found to have understated large amounts of profits through forging transaction records, and have provided staff and employees with excessive benefits in the forms of gym memberships, commercial

²⁴ Ibid 126-7. This view was also held by Dr. Wang Xiaoguang, director of the Beijing Rongzhi Institute for Corporate Social Responsibility. According to Wang, only about 10 per cent of the corporate social responsibility reports issued by Chinese companies have been prepared according to the international standards. Speech given by Dr. Wang at the Second Australia-China Investment Relations Conference in Beijing, 18 September 2013.

²⁵ These companies include China National Petroleum Corporation; China Petrochemical Corporation, China Telecommunications Corporation; China Coal Group Corporation, Anshan Iron and Steel Group Corporation, Baosteel Group Corporation; Wuhan Iron and Steel (Group) Corporation and China Merchants Group Limited etcetera.

²⁶ Daniel Ren, '83 SOE Officials Caught out by Audits', *South China Morning Post* News Story (15 August 2012) <<http://www.scmp.com/article/1002767/83-soe-officials-caught-out-audits>>.

²⁷ The 13 companies are State Nuclear Power Technology Corporation, State Development and Investment Corporation, China Publishing Group Corporation, Commercial Aircraft Corporation of China, Ltd., China Grain Reserves Corporation, China National Aviation Holding Company, China Mobile Communications Corporation, China Minmetals Corporation, China Guodian Corporation, China Huaneng Group, China Construction Bank, Agriculture Bank of China and China Import and Export Bank.

²⁸ For example, China Minmetals Corporation was found to have understated RMB300 million (approximately AUD50 million) of profits from 2005 to 2011, and RMB100 million in 2011 alone. No.5 of 2013 (General Serial No. 147): Audit Results of the Financial Revenues and Expenditures of China Minmetals Corporation for the Year 2011.

insurance and supplementary pension schemes. Furthermore, the group parent of China Mobile Limited was found to have spent RMB5.3 billion on computer rentals during 2005 to 2011, while the total value of the computers was less than half of the rental fees.²⁹ The release of the 2013 NAO audits inevitably led SOEs to 'once again find themselves in the midst of an image crisis'.³⁰ A number of executives of central SOEs, including the former Chairman of CNPC and several senior executives of China Mobile have been investigated for corruption.³¹

The lack of more dramatic changes in the overall governance practice of listed SOEs may have been caused by a number of factors. The first is the path dependent nature of corporate governance. This is particularly the case given the short history of the 2005 corporate law reforms. Substantial changes to the formal law may be introduced swiftly in response to pressures. Non-legal rules, such as conventions and norms are culture specific and will not change quickly in response to changes in the formal rules,³² and may therefore continue to shape the practice of corporate governance.

Another factor is the technical deficiencies in the amended laws, including the lack of detailed and workable rules. Chinese legislation has been described as 'vague, contradictory and lacking clear enforcement mechanisms'.³³ For example, the 2005 company law amendment has introduced many new concepts and principles on corporate governance, such as director's duties of care and loyalty. However, the lack of clear definition of these concepts and principles, and the relevant criteria for assessing breach, not only provides the courts with little guidance in their application, but also encourages negotiated compliance or even non-compliance.³⁴

²⁹ No.6 of 2013 (General Serial No. 148): Audit Results of the Financial Revenues and Expenditures of China Mobile Communications Corporation for the Year 2011.

³⁰ Li Huiru, 'Audits reveal SOE malpractice' *China Net News Story* (4 June 2012) <http://www.china.org.cn/business/2012-06/04/content_25559722.htm>.

³¹ 'Jiang' Jiemian: China Corruption Probe into Top Official' *BBC News Story* (1 September 2013) <<http://www.bbc.co.uk/news/world-asia-china-23918880>>; 'Another China Mobile Exec Investigated on Suspicion of Corruption', *Caixin* (online) News Story (19 August 2013) <<http://english.caixin.com/2013-08-19/100571515.html>>.

³² Douglass North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press, 1990) 45.

³³ Ho, above n 2, 433. Also see Donald Clarke, 'the Ecology of Corporate Governance in China' (GWU Legal Studies Research Paper No. 433; GWU Law School Public Law Research Paper No. 433, 29 August 2008) 14 <<http://ssrn.com/abstract=1245803,4>>.

³⁴ Nicholas Howson, 'Corporate Law in the Shanghai People's Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State' (2010) 5 *East Asia Law Review* 303, 397.

Milhaupt and Pistor's theorisation of the role of the state in conditioning legal changes with economic changes in state-led economies may serve as an additional explanation.³⁵ As discussed in Chapter 3, according to these authors, a strong and centralised state may utilise various tools, such as the limitation of the contestability of the law and substitution of law for norms, to retain control over the legal, including corporate law, system. Importantly, these tools may be employed not only in the process of formulation of law, but also in the implementation of law. As such, although substantial changes to the formal law may be introduced by the state in response to the pressures of globalisation and interest group politics, the state may continue to use these tools in the implementation of the legal changes, which renders changes in the law-in-practice much less substantial than formal legal changes.³⁶ Nevertheless, as the case study on the 2008 China milk scandal below will suggest, there is another factor that may have contributed to the lack of substantial changes in the reality of corporate governance in Chinese listed SOEs post-2005. This is the strong involvement of the state in various sets of company relations involved in the new state-led stakeholder model of corporate governance.

9.3 Internal working of the state-led stakeholder model of corporate governance in China: looking through the milk scandal

In the absence of large scale and detailed empirical work on the governance practices of Chinese listed SOEs, the central and local governments' involvement in the affairs of the companies implicated in the 2008 tainted milk scandal provides additional insights into the internal working of the Chinese state-led stakeholder approach to corporate governance. Although Sanlu, the group of companies at the epicentre of the scandal, was an unlisted privately-controlled corporate group converted from a former SOE, a number of other companies implicated in the scandal, including the one that was used by the government to rescue Sanlu, were listed SOEs.

9.3.1 An overview of the scandal and its main players

Despite the fact that corporate scandals are not rare in China, none had reached the degree of intensity and magnitude as the milk scandal. In September 2008, beginning with Sanlu, 22 companies, including almost all of the large and medium-sized producers in the Chinese dairy industry, were found by the State Administration of Quality

³⁵ Milhaupt and Pistor, above n 1, 31-39.

³⁶ As illustrated in Chapter 5, the 2005 *Company Law* introduces many new shareholders rights and remedies. However, minority shareholders face significant legal and judicial obstacles to resort to those rights and remedies for protection.

Supervision, Inspection and Quarantine (SAQSIQ), China's food safety authority, to be using melamine at various levels in their products.³⁷ By December 2008, the scandal led to six infant deaths and near 300,000 suffering from 'urinary problems' including kidney stones, according to the Chinese Ministry of Health.³⁸ Melamine, known as 'protein powder', is an industrial chemical used in producing plastics and fertilisers. Sustained consumption by human beings may cause kidney stones and kidney failure, particularly among infants for whom kidney stones are rare.³⁹

It is convenient to set out the four leading dairy groups implicated in the scandal at the outset. These are Sanlu (as mentioned earlier), Yili, Mengniu and Guangning Dairy. Sanlu was the group at the epicentre of the scandal. Indeed, most of the baby victims were fed Sanlu's lower-end infant formula by their middle to low income parents.⁴⁰ Headquartered in the northern city of Shijiazhuang, Hebei province, Sanlu used to be the largest infant formula producer, as well as one of China's top 500 enterprises. The predecessor of Sanlu was a cooperative of local dairy farmers, which, under the Chinese Constitution, is a special form of state ownership.⁴¹ The cooperative was then converted into a joint venture, although it continued to be widely perceived as a SOE in the market. Immediately prior to the scandal, 56 per cent shares in Sanlu were held by its management and employees through a company called Sanlu Limited.⁴² Another 43 per cent were held by the New Zealand dairy giant Fonterra, which appointed three of the seven directors on Sanlu board.⁴³ The remaining one per cent shares in Sanlu were held by several small shareholders.⁴⁴ Public listing of Sanlu was sought prior to the establishment of the joint venture. Commentators suggested that if not for the exposure

³⁷ 'China Seizes 22 Companies with Contaminated Baby Milk Powder' *Xinhua Net News Story* (17 September 2008) <http://news.xinhuanet.com/english/2008-09/17/content_10046949.htm>.

³⁸ 'Two Executed in China over Tainted Milk Scandal' *Xinhua Net News Story* (24 November 2009) <http://news.xinhuanet.com/english/2009-11/24/content_12530798.htm>.

³⁹ World Health Organisation, 'Melamine-contaminated Powdered Infant Formula in China - Update 2' (29 September 2008) <http://www.who.int/csr/don/2008_09_29a/en/>.

⁴⁰ 'Two Executed in China over Tainted Milk Scandal', above n 38.

⁴¹ 《中华人民共和国宪法》 [Constitution of the People's Republic of China] art 6.

⁴² 张旭 [Zhang Xu], '还原三鹿前世今生' [An Overview of SanLu's History], *China Times* (online) (22 September 2008) <<http://www.chinatimes.cc/huaxia/pages/159/moreInfo.htm>>.

⁴³ Richard Spencer and Peter Foster, 'China Milk Scandal Threatens Giant Dairy Firm', *The Telegraph* (online) (24 September 2008) <<http://www.telegraph.co.uk/news/worldnews/asia/china/3073998/China-milk-scandal-threatens-giant-dairy-firm.html>>.

⁴⁴ The ownership of Sanlu became a controversial issue at the exposure of the scandal, as many people believed Sanlu was a state-owned enterprise. At a press conference held on 13 September 2008, Mr. Yang Chongyong, Vice-governor of Hebei Province denied any government ownership in Sanlu. See '河北省副省长:政府在三鹿集团有限公司中没有股份' [Hebei Vice-Governor: Government Does not Own Shares in Sanlu], *China Central Television News* (online) (13 September 2008) <<http://news.cctv.com/china/20080913/103040.shtml>>.

of the scandal, Sanlu could have been listed on the Shanghai Stock Exchange by 2008.⁴⁵ Yili is a company based in Inner Mongolia and listed on the Shanghai stock exchange. Yili's largest shareholder, the Inner Mongolia Autonomous Region government, owned about 10 per cent shares in the company in 2007. The balance was distributed among public investors including securities investment funds. Mengniu, another Inner Mongolia-based dairy giant, is a Hong Kong-listed company. The ultimate controllers of Mengniu were its founders, primarily the Chairman who was also the General Manager. Guangming Dairy is a listed company controlled by the Shanghai municipal government through two local SOEs.⁴⁶

Sanlu was placed into liquidation in December 2008, following failed negotiations for the group to be taken over by Sanyuan Foods. The latter is a listed SOE controlled by the Beijing municipal government. By January 2009, a number of former Sanlu senior executives and other persons involved in the scandal had been convicted of different criminal offences. Work on the compensation for tort victims had also been finalised, with most of the victims' families accepting a compensation scheme put forward by the dairy companies and backed by the central and local governments. Sanlu was declared insolvent and forced into bankruptcy in February 2009. In March 2009, the assets of the bankrupt Sanlu were purchased by Sanyuan through public auction, with the bidding terms tailor-made to Sanyuan, who also took over responsibility for Sanlu's employees. The Sanlu bankruptcy case was concluded on 22 November 2009, within 10 months following the issue of the bankruptcy order.⁴⁷

As illustrated below, the central and local governments' involvement in corporate affairs in the lead up to the scandal reflected some key features of the Chinese pre-2005 state-led model of corporate governance, such as close state-manager relations and poor protection of outsider stakeholders, including consumers. By contrast, the handling by the governments, especially the central government, of the aftermath of the scandal resonates more with the new state-led stakeholder approach to corporate governance that has emerged in China post-2005. Indeed, the way in which the scandal was handled

⁴⁵ 龙丽 [Long Li], '三鹿相关材料已报批有望 2008 年实现 A 股上市' [Application Submitted, Sanlu Hopeful of Getting Listed in A Share Market in 2008], *21 Century Economic Report* (online) (17 September 2008) <<http://news.hexun.com/2008-09-17/108945053.html>>.

⁴⁶ The 2007 and 2008 Annual Reports of Yili Industrial Group Co Ltd, China Mengniu Dairy Co Ltd and Guangming (Bright) Dairy Shareholding Co., Ltd.

⁴⁷ Yan Wang, 'Compensation Lawsuit over Tainted Milk Postponed', *China Daily* (online) (9 December 2009) <http://www.chinadaily.com.cn/business/2009-12/09/content_9144184.htm>.

suggests that the Chinese state has many more informal tools, apart from formal regulation, to give effect to such an approach. In the scandal aftermath, the central government remained mindful of promoting economic development through business growth and expansion. However, it assumed a far more proactive and inclusive role in pursuing that objective. Consequently, a number of tools were adopted to strike a balance among competing corporate stakeholder interests affected by the scandal. Nevertheless, as discussed below, this far more proactive and inclusive role played by the state has paradoxically contributed to the lack of dramatic changes in the governance practice in Chinese listed SOEs post-2005.

9.3.2 State involvement in the lead up to the scandal and the pre-2005 state-led model of corporate governance

In its aftermath, the 2008 milk scandal has been widely attributed to a combination of the relentless self-interest of the milk station operators and poor internal controls of dairy companies in sourcing raw milk. However, at a deeper level, an important cause for the scandal was the extremely close state-manager relations in promoting business expansion, at the expense of the interests of company outsider stakeholders including the consumers.

The milk station operators added melamine to diluted raw milk to artificially raise its protein levels.⁴⁸ However, the self-seeking behaviour of the milk station operators cannot be separated from lax internal controls of the dairy companies in sourcing raw milk. As a report provided by Xinhua News Agency stated:

The testing and quality check personnel can't have been completely ignorant or innocent. An explanation is that the milk company's rapidly expanding business scales led to a shortage of milk sources, which forces them to collect milk loosely, turning a blind eye to poor quality raw milk.⁴⁹

Indeed, the dairy companies' overreliance on milk station operators to collect raw milk in itself, suggests poor internal controls. Dairy companies in China used to run their own dairy farms, where quality control over raw milk supply was less problematic. However, with the Chinese dairy industry growing at an average annual rate of 23 per cent since 2000,⁵⁰ fierce competition for raw milk became industry-wide. In a quest to expand milk sources in the most 'cost effective' ways, most large dairy companies,

⁴⁸ Yang Jianxiang, 'Survivor Leads China's Milk Industry', *Xinhua Net News Story* (15 November 2008) <http://news.xinhuanet.com/english/2008-11/15/content_10361534_3.htm>.

⁴⁹ Ibid.

⁵⁰ '乳制品工业产业政策发布' [Chinese Dairy Industry Policy Released], *China Economic Net News Story* (17 June 2008) <http://finance.ce.cn/macro/gdxw/200806/17/t20080617_13226765.shtml>.

including Sanlu, Mengnui and Yili, turned to privately-run milk collection stations to purchase raw milk from small dairy farmers. Consequently, due to the poor quality controls of the dairy companies and the extremely low prices they set for raw milk, 'spiking raw milk with all sorts of additives, such as melamine' became a 'public secret' in the industry, at least within Hebei province.⁵¹

Poor internal controls aside, the Sanlu's case presented an example of outright disregard for corporate social responsibility. The company had been receiving complaints about babies who had become ill after drinking Sanlu's infant formula since December 2007. However, during the eight months that followed, the management of Sanlu took extensive measures to cover up the scandal, leaving the number of infant victims to continue to grow. This was until early August 2008, when tests reluctantly carried out by Sanlu with an outside agency confirmed melamine contamination in Sanlu's infant formula.⁵²

In Sanlu's case, a close local government-business relationship was manifested in the former's extensive delay in reporting Sanlu's milk contamination incident to the Hebei provincial government. It took the Shijiazhuang government 38 days to forward Sanlu's report to the provincial government, rather than within two hours as required by a relevant central government regulation.⁵³ This meant that the central government was not informed of the incident until 9 September, nine months since the first sign of the melamine tainted milk.⁵⁴ When asked to explain the extensive delay, a spokesperson of

⁵¹ 徐超 [Xu Chao], '三聚氰胺溯源' [Tracing the Source of Melamine], *Caijing Magazine* (online) (29 September 2008) <<http://magazine.caijing.com.cn/20080928/77700.shtml>>. The practice of spiking source milk with melamine was traced back to April 2005 by the Deputy Governor of Hebei Province. See '河北省副省长透露：不法分子 2005 年已开始向牛奶掺三聚氰胺' [Deputy-Governor of Hebei: Law Offenders Started to Add Melamine to Raw Milk from 2005], *21 Century Economy Reports* (online) (18 September 2008) <<http://news.cnfol.com/080918/101,1280,4781164,00.shtml>>.

⁵² Spencer and Foster, above n 43; '三鹿事件真相大曝光' [Truth of Sanlu Incident Revealed] *Xinhua Net News Story* (1 January 2009) <http://news.xinhuanet.com/politics/2009-01/01/content_10587575.htm>.

⁵³ 《国家重大食品安全事故应急预案》 [National Emergency Plan for Handling Major Food Safety Accidents] (People's Republic of China) State Council (27 February 2006), s3.2.2.

⁵⁴ '党中央国务院严肃处理三鹿奶粉事件相关责任人员' [Central Party Committee and State Council Dealing with Persons Involved in the Sanlu Milk Scandal Seriously] Chinese Central Government Website News Update, 22 September 2008 <http://www.gov.cn/jrzq/2008-09/22/content_1102256.htm>. There have been different explanations regarding how the scandal was exposed. Sanlu's New Zealand partner Fonterra claimed that it was informed by its Chinese partner of the milk contamination on 2 August, 2008, the same day on which the Shijiazhuang city government was informed. After three unsuccessful meetings with the Shijiazhuang health officials to raise the alarm, the company reported the incident to the New Zealand Foreign Affairs Department on 22 August, which led to the issue finally being brought to the attention of the Chinese central government by the former New Zealand Prime Minister on 9 September. See Spencer and Foster, above n 43.

the Shijiazhuang government referred to 'support for local businesses',⁵⁵ and cited a letter from Sanlu that pleaded the government to 'increase control and coordination of the media, to create a good environment for the recall of the company's problem products ... to avoid whipping up the issue and creating a negative influence in society'.⁵⁶ The relationship between Sanlu and the Shijiazhuang government was so close that it even 'convinced' Fonterra, the New Zealand joint venture partner of Sanlu, to 'work within the system' to effect an official product recall. When informed of the milk contamination by its Chinese partner, Fonterra went public only after three failed meetings with the Shijiazhuang municipal authorities.⁵⁷

It might be argued that, as an individual case, the close relationship between Shijiazhuang government and Sanlu management should not be generalised. However, as noted in Chapter 2, with China's adoption of economic growth as a policy priority, the Chinese government has often assumed the role of a business promoter. This role also applies to local governments, as their officials were rewarded and punished by higher authorities primarily on economic performance, measured in GDP terms.⁵⁸ As such, in a similar circumstance, one can expect the adoption of a similarly protective approach by another local government, albeit to a lesser extent.

Indeed, as the milk scandal revealed, close state-business relations were not limited to the local levels. Public criticism focused on the central government's excessively business-friendly approach to regulating a fundamental area of food safety. SAQSIQ introduced a system of exemption for quality inspection in 2000, to 'ease the burden for companies that otherwise would undergo repeated inspections'.⁵⁹ The system allowed many companies including dairy giants like Sanlu to enjoy the quality inspection-free

⁵⁵ 王明皓 [Wang Minghao], '石家庄市新闻发言人:三鹿事件为何迟迟不报' [Spokesperson for Shijiazhuang Government: Why Report of Sanlu Incident was Delayed], *People's Net News Story* (1 October 2008) <http://paper.people.com.cn/rmrb/html/2008-10/01/content_112000.htm>; 'China Dairy 'Asked for Cover-up'', *BBC News* (online) (1 October 2008) <<http://news.bbc.co.uk/2/hi/asia-pacific/7646512.stm>>.

⁵⁶ 王明皓 [Wang Minghao], above n 55.

⁵⁷ Spencer and Foster, above n 43; Also see Shanshan Wang, 'Fonterra CEO Reflecting on Investing in China', *Caijing Magazine* (online) (5 December) 2008 <<http://www.caijing.com.cn/2008-12-05/110035012.html>>.

⁵⁸ Hongbin Li and Li-An Zhou, 'Political Turnover and Economic Performance: the Incentive Role of Personnel Control in China' (2005) 89 *Journal of Public Economics* 1743, 1744.

⁵⁹ Yang Binbin, 'Food Product Inspection Waivers Revoked' *Caijing Magazine* (online) (18 September 2008) <<http://english.caijing.com.cn/2008-09-18/110013644.html>>.

status. This was despite alarms on food safety in China repeatedly raised by a series of major scandals.⁶⁰

The 2008 tainted milk scandal revealed many of the dangers associated with the former state-led model of corporate governance. As state association with companies to promote economic growth and business expansion became a common objective, other governance issues such as monitoring of managers and protection of investor and other stakeholder interests were simply ignored.

On the other hand, as the discussion of the handling of the scandal aftermath below will suggest, while close state-manager relations continued to underpin this latter process, the central government took on a more inclusive approach towards the protection of company outsider stakeholders such as tort victims and trade creditors. Nevertheless, while this all-encompassing approach was pivotal in putting a major corporate scandal to a quick end, its effect on the governance practices within Chinese companies remains questionable.

9.3.3 The handling of the scandal aftermath and the state-led stakeholder approach to corporate governance

The state-led stakeholder approach adopted by the central government in the scandal aftermath was obviously driven by multiple pressures. Apart from its effect on hundreds of thousands of infant victims, the exposure of the scandal threw the fast-growing Chinese dairy industry, accounting for about 30 per cent of the Chinese food industry, into a major crisis. While the Sanlu group of 30 subsidiaries and entities became hopelessly insolvent, other dairy groups, including Yili and Mengniu, were also deeply affected, as their sales plummeted with lost consumer confidence and worldwide bans on Chinese dairy products.⁶¹ Furthermore, as state involvement in corporate affairs was an important cause of the scandal, the legitimacy of the Chinese form of state-led economic development was also at risk.

State involvement in corporate affairs to promote economic development and business growth remained a major theme in the handling of the demise of Sanlu. Placing Sanlu into liquidation would be a good test case for the new Chinese *Enterprise Bankruptcy*

⁶⁰ These included a separate incident in 2004 where about ten babies were reportedly killed by fake or defective infant formula sold in Anhui Province. See Di Fang 'Milk Powders Kill Babies in Anhui Province', *China Daily* (online) (20 April 2004) <http://www.chinadaily.com.cn/english/doc/2004-04/20/content_324727.htm>.

⁶¹ 王锦 [Wang Jin] '中国乳业危机行业洗牌不可避免' [Crisis of Chinese Dairy Industry: Restructure Inevitable], *China Securities Net News Story* (22 September 2008) <http://www.cs.com.cn/xwzx/05/200809/t20080922_1591661.htm>.

Law.⁶² Drawing heavily from the US bankruptcy law regime, the new *Enterprise Bankruptcy Law* was introduced in August 2006 to replace an old piece of legislation that only applied to industrial SOEs.⁶³

Although Sanlu did not escape a court-ordered liquidation eventually, this fate was not intended by the government in the first place. This can be seen from the refusal of the Shijiazhuang Intermediate Court to hear an earlier bankruptcy application filed against Sanlu by one of Sanlu's sales agents. The refusal was given with no clear reason.⁶⁴ However, as discussed below, the same court subsequently heard Sanlu's bankruptcy case when all efforts to rescue Sanlu failed.

The idea of having Sanlu taken over by another company was preferred by the central and local governments for various reasons. The famous 'Sanlu' brand became worthless. However, other 'intangible assets' accumulated by Sanlu (ranging from advanced production and marketing systems to extensive network for sourcing milk) in its 20 years of history could be better preserved through a takeover.⁶⁵ In addition, should Sanlu be allowed to stay in business, there would be a greater chance for Sanlu to repay its debts and retain its over 10,000 employees. All these liabilities posed a serious threat not only to the local Shijiazhuang government, but also to economic development and social stability at the national level.

The takeover plan emerged on 26 September, when shares in the Beijing-based Sanyuan Foods were suspended, and the company announced that it 'had received a notice from the government to consider a Sanlu merger plan'.⁶⁶ Industry experts said Sanyuan was chosen to takeover Sanlu for two main reasons: first, the company was the only relatively large Chinese dairy company that was not implicated by the scandal, and

⁶² 《中华人民共和国企业破产法》 [The Enterprise Bankruptcy Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 August 2006.

⁶³ The *Enterprise Bankruptcy Law* was introduced to replace an old statute that had operated on a trial basis and applied only to the industrial SOEs. Drawing upon international experience in insolvency law and practice, the new legislation provides for bankruptcy procedures including liquidation, compromise as well as an American style reorganisation.

⁶⁴ '三鹿破产案：是消失还是涅槃' [Sanlu Bankruptcy Case, Death or Rebirth?] *Xinhua Net News Story* (5 January 2009) <http://news.xinhuanet.com/fortune/2009-01/05/content_10604233.htm>.

⁶⁵ *Ibid.*

⁶⁶ '知情人士谈三元并购三鹿：三元身不由己' [Insiders Comment on Sanyuan Sanlu Merger: not Sanyuan's Will], *Xinhua Net News Story* (4 January 2009) <http://news.xinhuanet.com/fortune/2009-01/04/content_10598930.htm>; Wang Qian, 'Sanyuan May Take over Tainted Milk Brand Sanlu', *China Daily* (online) (27 September 2007) <http://www.chinadaily.com.cn/china/2008-09/27/content_7064279.htm>.

second, Sanyuan is a state-controlled company, which 'makes it easier for the government to manipulate'.⁶⁷

The proposed Sanyuan takeover of Sanlu was, however, widely considered 'an impossible mission'.⁶⁸ The differences in size and scale between Sanyuan and Sanlu were enormous. Sanlu was one of the leading Chinese dairy groups with businesses around the country. Sanyuan, with its annual sales amounting to only about 10 per cent of Sanlu, was largely unknown to consumers outside Beijing. Sanyuan claimed that the acquisition would raise its market share by adding to its liquid milk operations an extra line of business in powdered milk. Industry experts, however, suggested that problems such as business integration and cash flow, particularly with the indeterminate amount of tort liabilities faced by Sanlu, could drag Sanyuan into bankruptcy. Further, the fundamental problem that had caused the demise of Sanlu, i.e., its heavy reliance on milk dealers for raw milk, could pose a significant threat to Sanyuan's branding. The Sanyuan takeover plan did not eventuate, and was followed by an order of the Shijiazhuang Intermediate Court placing Sanlu into liquidation (on the application of a local branch of a state-owned bank, a Sanlu creditor). However, with the backing of Beijing and Hebei governments, the takeover negotiations went on for months before the bankruptcy order was issued.⁶⁹

The Sanlu liquidation case turned out to be another politically manipulated process, due to similar considerations that had underlined the government-backed takeover plan. Sanyuan became 'perhaps the greatest winner' in Sanlu's demise.⁷⁰ Sanlu was declared insolvent on 12 February 2009. On 4 March 2009, Sanyuan acquired Sanlu's assets in insolvency at a public auction with the bidder criteria tailor-made to Sanyuan: the auction was only open to Chinese domestic dairy producers that had not been implicated in the milk scandal.⁷¹ As some core enterprises in the Sanlu group had already resumed production under lease agreements with Sanyuan before the auction,

⁶⁷ '知情人士谈三元并购三鹿：三元身不由己' [Insiders Comment on Sanyuan Sanlu Merger: not Sanyuan's Will], above n 66.

⁶⁸ Zhan Xu, '三鹿：完达山旁观三元或孤独破局' [Wandashan Onlooking Sanlu Takeover: Sanyuan Likely to Struggle Alone], *Xinhua Net News Story* (5 November 2008) <http://cs.xinhuanet.com/cqzk/05/200811/20081120_1659972.htm>.

⁶⁹ '三元并购三鹿：关系敏感的局中局' [Sanyuan Taking Over Sanlu, A Sensitive Case] *Xinhua Net News Story* (2 January 2009) <http://news.xinhuanet.com/fortune/2009-01/02/content_10590487.htm>.

⁷⁰ Lauren M Katz, 'Class Action with Chinese Characteristics: the Role of Procedural Due Process in the Sanlu Milk Scandal' (2010) 2 *Tsinghua China Law Review* 421, 466.

⁷¹ 'Sanyuan Buys Scandal-hit Sanlu Dairy Company at Auction', *People's Daily* (online) (4 March 2009) <<http://english.peopledaily.com.cn/90001/90783/91300/6606135.html>>.

commentators said that the 'government-led bankruptcy' of Sanlu probably worked even more favourably for Sanyuan, as it provided the company with an opportunity to acquire Sanlu's assets without its liabilities.⁷² The Sanlu bankruptcy case was concluded on 22 November 2009, within 10 months following the issue of the bankruptcy order.⁷³

The swift handling of the bankruptcy case could not have been achieved without Sanlu's out-of-court settlements with its tort victims and trade creditors. The carefully coordinated and government-backed settlement plans, particularly for the tort victims, not only played a crucial role in directing the tort claims away from the courts, but also demonstrated the all-encompassing approach adopted in China's state-led stakeholder model of corporate governance.

The compensation for the tort victims was one of the most contentious issues in the aftermath of the milk scandal. Had the scandal occurred in a Western market economy such as Australia, one would expect a slew of lawsuits, or more likely, class actions being launched on behalf of the tort victims against the dairy companies, as well as the Shijiazhuang municipal government (should the government be found to have played a part in the loss or injury suffered by the victims). If this situation is permitted, the associated bad publicity would not only lead the local and central governments into disgrace, but also jeopardise economic development and social stability.

Curiously, in the aftermath of the scandal, no single tort claim against either Sanlu or any other dairy companies was reportedly heard in any Chinese court. It is not that the Chinese law failed to provide any redress for these victims. To the contrary, the 1986 *General Principles of Civil Law* (which sets out a basic framework for Chinese civil and commercial legislation) imposes on manufacturers, as well as sellers, the liability for economic loss and physical injury caused by defective goods.⁷⁴ This general provision has been reinforced by at least two pieces of legislation on consumer protection, namely the *Law on the Protection of Consumers' Rights and Interests* (the 'Consumer Protection Law') and the *Product Quality Law*.⁷⁵ Article 35 of the *Consumer Protection*

⁷² '三鹿将宣告破产传言利好三元收购' [Sanlu to be Declared Bankruptcy: Rumoured in Favour of Sanyuan Takeover] *Xinhua Net News Story* (23 December 2008) <http://news.xinhuanet.com/fortune/2008-12/23/content_10547631.htm>.

⁷³ Yan Wang, above n 47.

⁷⁴ 《中华人民共和国民事诉讼法》 [Civil Procedure Law of the People's Republic of China] (People's Republic of China) National People's Congress, 9 April 1991, art 122.

⁷⁵ 《中华人民共和国消费者权益保护法》 [Law of the People's Republic of China on the Protection of Consumers' Rights and Interests], (People's Republic of China) National People's Congress Standing Committee,

Law, echoed in Article 31 of the *Product Quality Law*, allows a “consumer or other victim” who suffers economic loss or physical injury as a result of defective goods to claim compensation from both the seller and the manufacturer. The heads of damages include ‘medical expenses, nursing expenses during medical treatment, and the reduced income for loss of working time and other expenses’.⁷⁶ Should a consumer or victim be ‘disabled’ by the defective product, the compensation should also include ‘the victims’ expenses for self-help devices, living allowances, compensation for disability and the necessary living cost of the persons supported by the disabled’. Further, should death be caused by defective goods, the defendant will also be liable for ‘funeral expenses, death compensation and the necessary living cost of the persons supported by the deceased during their lifetime’.⁷⁷ Although Chinese legislation does not provide for compensation for pain and suffering (‘mental loss’ in Chinese terms) or exemplary damages, it is not rare for the court to award such compensation in practice, under either the heads of ‘compensation for disability’, ‘compensation for death’ or a judicial opinion issued by the SPC on ‘mental and spiritual loss’ in civil claims.⁷⁸

In relation to the forms of litigation, as discussed in Chapter 7, the Chinese *Civil Procedure Law* provides for individual actions, ‘representative suits with fixed number of litigants’,⁷⁹ as well as ‘representative suits where the number of litigants comprising one party is unfixd at the commencement of the action’.⁸⁰ The SPC has disallowed the second type of collective action, which accords with the US-style class action, for securities-related civil claims. It, however, has not banned the action for other tort claims including consumer claims.

Nevertheless, despite availability of the legal remedies, the central government opted for extra-legal mechanisms to achieve ‘better justice’ to the tort victims, as well as for a

31 October 1993; 《中华人民共和国产品质量法》[Product Quality Law of the People's Republic of China (People's Republic of China) National People's Congress Standing Committee, 22 February 1993.

⁷⁶ 《中华人民共和国消费者权益保护法》[Law of the People's Republic of China on the Protection of Consumers' Rights and Interests] art 41; 《中华人民共和国产品质量法》[Product Quality Law of the People's Republic of China] art 32.

⁷⁷ 《中华人民共和国消费者权益保护法》[Law of the People's Republic of China on the Protection of Consumers' Rights and Interests], above n 76, art 42.

⁷⁸ 《关于确定民事侵权精神损害赔偿责任若干问题的解释》[Explanation of Several Issues Relating to The Assessment of Mental Losses in Civil Litigation] (People's Republic of China) Supreme People's Court, 8 March 2001.

⁷⁹ 《中华人民共和国民事诉讼法》[Civil Procedure Law of the People's Republic of China] (People's Republic of China) National People's Congress, above n74, art 54.

⁸⁰ Ibid art 55.

quick resolution of the scandal. The compensation plan emerged on 30 December 2008, one week after Sanlu was issued the bankruptcy order. The state media *China Daily* announced that the 22 dairy companies implicated in the milk scandal, including Sanlu, had committed RMB900 million (US\$131 million) as 'one-off compensation'⁸¹ to all tort victims. Hence, each victim family would receive an amount ranging from RMB2,000 (US\$292) to RMB30,000 (US\$4,400), depending on the degree of sickness of their babies, or a payment of RMB200,000 (US\$29,000) in case of death. In addition, a RMB200 million fund was to be established by the companies to 'cover medical bills for any lingering problems related to the tainted milk'.⁸² The fund would also allow the tort victims to access insurance coverage with a leading state-controlled insurance company for the 'full amount of medical bills related to the tainted milk incurred before they turn 18 years of age'.⁸³

This arrangement was not, as it appeared to be, a purely voluntary act of the dairy companies. As early as 10 December 2012, following three months of contention surrounding the issue of victim compensation, the Ministry of Health issued a media release stating that 'relevant departments are now considering a compensation plan for the Sanlu infant milk powder incident', and 'the Ministry was compiling information about the victims who may receive compensation'.⁸⁴ No further details of the plan were subsequently released. As a corollary to the government's silence, there was, however, sporadic media exposure of victim claims being rejected by several Chinese courts, as the courts were waiting for 'instructions from the government', or 'a compensation plan to be released by the government'.⁸⁵ News reports also suggested that the RMB900

⁸¹ Zhe Zhu and Xiaohuo Cui, '22 Dairy Firms to Pay \$160m in Compensation', *China Daily* (online) News Story (30 December 2008) <http://www.chinadaily.com.cn/cndy/2008-12/30/content_7351554.htm>.

⁸² Ibid.

⁸³ '结石患儿民事赔偿案无一获受理 河北律协解释' [Why Tort Claims Associated with the Milk Scandal refused to be heard by Courts? Explained by Hebei Lawyers Association] *Xinhua Net* News Story (7 January 2009) <http://news.xinhuanet.com/legal/2009-01/07/content_10615043.htm>.

⁸⁴ 周婷玉 [Zhou Tingyu], '中国相关部门正在讨论问题奶粉时间赔偿方案' [Relevant Chinese Departments Considering a Compensation Plan for Problem Powdered Milk Victims], *Xinhua Net* News Story (10 December 2008) <http://news.xinhuanet.com/newscenter/2008-12/10/content_10484532_1.htm>.

⁸⁵ '结石患儿民事赔偿案无一获受理 河北律协解释' [Why Tort Claims Associated with the Milk Scandal refused to be heard by Courts? Explained by Hebei Lawyers Association] above n 83; '三鹿索赔暂不立案：谁来赔偿受害者' [Compensation Claims against Sanlu Suspended: Who Will Compensate the Victims?], *China News Net* News Story (11 November 2008) <<http://www.chinanews.com.cn/cj/xfsh/news/2008/11-11/1445254.shtml>>; 'Courts Compound Pain of Chinese Tainted Milk', *New York Times* (online) (17 October 2008) <<http://www.nytimes.com/2008/10/17/world/asia/17milk.html?fta=y>>.

million contributed by Sanlu to the compensation plan, one week before it was declared bankruptcy, was raised “with the assistance” of the Shijiazhuang government.⁸⁶

The implementation of the compensation plan has been generally considered a successful example of government-led resolution of mass dispute, despite controversies surrounding the inadequacy of the compensation proposed.⁸⁷ The extremely high acceptance rate by the tort victims’ families was not surprising.⁸⁸ Firstly, for those victims who suffered minor injuries, free medical treatment and a small one-off compensation payment may be seen as adequate.⁸⁹ Secondly, for the victims’ families that suffered major loss, there was no guarantee that they could receive more than what the plan had offered. These families were ranked equally with other unsecured creditors at the bottom for distribution of the bankruptcy assets.⁹⁰ And thirdly, given the background of the tort victims’ families, many with a low economic status, poor education and limited travel experience, the difficulties faced by them in bringing a complex law suit before the Shijiazhuang Court were insurmountable. As such, a government-coordinated compensation scheme is arguably a more effective means to ‘maximise substantive justice for the greatest number of victims in a practical manner’.⁹¹

Indeed, in Sanlu’s case, state coordination of company relations with their outsider stakeholders was not limited to dealing with tort victims. The swift conclusion of the Sanlu bankruptcy case was also facilitated by a government-backed debt repayment

⁸⁶ ‘石家庄官方称抵押政府大院筹三鹿赔款子虚乌有’ [Shijiazhuang Official Dismissed Alleged Government Assistance of Sanlu to Repay Debt by Mortgaging Government Office Buildings] *Xinhua Net News Story* (8 January 2009) <http://news.xinhuanet.com/politics/2009-01/08/content_10625612.htm>.

⁸⁷ Zhu and Cui, above n 81. According to Zhu and Cui, many parents found the 2000 yuan for ‘the minor kidney problems’ is too inadequate to accept. Other criticisms on the inadequacy of compensation plan related to the scope and the period of the insurance coverage and the lack of involvement of the families of the tort victims in the formulation of the scheme.

⁸⁸ ‘超 90% 婴幼儿奶粉事件患儿家长已接受主动赔偿’ [Over 90 per cent Tort Victims of Tainted Milk Incident Have Accepted Compensation Voluntarily], *Xinhua Net News Story* (24 January 2009) <http://www.he.xinhuanet.com/news/2009-01/24/content_15543516.htm>.

⁸⁹ Katz, above n 70, 466.

⁹⁰ The order of distribution of bankruptcy assets provided in Article 113 of the EBL is as follows: (1) bankruptcy expenses and common benefits debts (certain debts incurred by the debtor company after the commencement of the bankruptcy proceedings such as those arising from agency by necessity or personal loss or injury caused by the company property; (2) unpaid wages and other welfare payments; (3) unpaid social insurance premiums and taxes; (4) unsecured claims; Where the insolvent assets are not enough to satisfy the debts in the same ranking, the *pari passu* rule will apply. Note that there is currently a debate among the Chinese legal scholars on whether the debt owed to tort victims by Sanlu should be classified as common benefits debt. 《中华人民共和国企业破产法》 [The Enterprise Bankruptcy Law of the People’s Republic of China] (People’s Republic of China) National People’s Congress Standing Committee, 27 August 2006, art 113.

⁹¹ Katz, above n 70, 466.

plan reached between Sanlu and its unsecured trade creditors. The agreement was signed by Sanlu Trading Company, a wholly-owned subsidiary of Sanlu on its behalf.⁹² It was finalised on 23 December, when the Shijiazhuang court's delivery of the bankruptcy order to Sanlu led over 300 Sanlu's sales agents, most unsecured creditors, to gather at the Sanlu headquarters and in front of Hebei Provincial government. On the same day, following a meeting between 'the Hebei Provincial Communist Party Committee, the Provincial government, and the Shijiazhuang city Party Committee and the government', the Hebei and Shijiazhuang governments agreed to 'guarantee the co-ordination of the full repayment should Sanlu have difficulties in repaying the debts'.⁹³

The validity of the separate debt repayment agreement is dubious. Under Article 16 of the Chinese *Bankruptcy Law*, once a court has accepted an application for bankruptcy, any repayment of debts by the debtor company to individual creditors should be void. However, in the Sanlu bankruptcy case, it appeared that neither the Court nor the bankruptcy administrator (headed by an official of the Shijiazhuang State-owned Assets Supervision Commission)⁹⁴ exercised their power to set aside the agreement. Furthermore, Sanlu Trading Company, the wholly-owned subsidiary of Sanlu, which had signed the agreement on behalf of Sanlu with its trade creditors, was excluded from the liquidation process.⁹⁵

Indeed, the Chinese central and local governments' involvement in the handling of the 2008 milk scandal reflected the state-led stakeholder model of corporate governance arising from China's post-2005 corporate law reforms. Strong state involvement in corporate affairs to promote economic development remained the priority. However, compared to the pre-2005 state-led model, the state assumed a far more active role in coordinating competing interests of different corporate stakeholder groups affected by the scandal. Government involvement in corporate failures with mass effects may occur in all systems. However, the type of state involvement in the milk scandal aftermath, for example, government orchestration of the bankruptcy and the compensation scheme

⁹² 李静 [Li Jing], '三鹿破产拍卖还债估计三鹿总负债近 20 亿元' [Sanlu to be Sold through Bankruptcy Auction: Total Debts Estimated Nearly RMB2 Billion] *Xinhua Net News Story* (25 December 2008) <http://news.xinhuanet.com/fortune/2008-12/25/content_10555709.htm>.

⁹³ 石家庄市政府通报三鹿集团破产案情况(全文) [Shijiazhuang City Government Report on Sanlu Bankruptcy Case (full text)] *Xinhua Net News Story* (25 December 2005) <http://news.xinhuanet.com/fortune/2008-12/25/content_10557898.htm>.

⁹⁴ '三鹿破产清算小组十四人组成' [Fourteen-Member Sanlu Bankruptcy Liquidation Team Formed], *Dongfang Daily* (online), 31 December 2008 <<http://www.dfdaily.com/html/113/2008/12/31/351068.shtml>>.

⁹⁵ 李静 [Li Jing], above n 92.

before the court became involved, is unusual in Anglo-American jurisdictions. As discussed next, this model has played an important role in maintaining China's rapid economic development and social stability. Nevertheless, the inherent disadvantages associated with this model also help to explain the limited success achieved by China's post-2005 legal and regulatory reforms of corporate governance.

9.4 How can we interpret the changes and the lack thereof?

State-led corporate governance has both advantages and disadvantages. As noted in Chapter 3, focusing on state-led corporate social responsibility, Ho argued that one of the greatest advantages of the state-led model is the capacity of the state to bring together a variety of formal and informal tools to promote legal compliance and corporate commitment to social responsibility.⁹⁶ Some of these tools, such as the formulation and enforcement of law and regulation and other state-sponsored programs, are not commonly available to private sector organisations. Further to the resourcefulness of the state, an important advantage of this model lies in its 'inherent communicative effect'.⁹⁷ State-led or sponsored initiatives may send a strong signal to the business community about government's endorsement of corporate social responsibility, and may therefore play a major role in guiding the formation of norms about the importance of respect for law and social responsibility.

Nevertheless, the state-led model has some important disadvantages. An obvious disadvantage is that where a pervasive role is played by the state in monitoring and disciplining corporate social responsibility, the scope for law and market-based mechanisms, such as civil society organisations and the business community, to play a part in this area is narrowed.⁹⁸

Further, where the state is left as the single most important determinant in this model, the advantages of the state-centric approach as outlined above may turn out to be its disadvantages. Firstly, because the various state-led initiatives depend on the will and capacity of state agencies and government officials for implementation, the lack of either detracts from the effectiveness of the model.⁹⁹ Secondly, although state-backed initiatives may send a strong signal about the importance of compliance with corporate

⁹⁶ Ho, above n 2, 431-2.

⁹⁷ Ibid 434

⁹⁸ Ibid 437.

⁹⁹ Ibid 432.

social responsibility, the formation of the relevant norms among business community, as well as the wider society, depends on the 'consistency of the message and the legitimacy of the state itself as a CSR [corporate social responsibility] supporter'.¹⁰⁰ A lack of consistency in the message, for example, due to the conflicting goals of the state in promoting economic development through preserving social stability and maintaining good corporate governance, may lead businesses into misconceptions about the content and standard of responsibilities expected of them by the state.¹⁰¹ This is particularly the case where the legitimacy of the state, as a supporter of corporate responsibility, is undermined when the government, or government-endorsed corporate responsibility leaders, 'turn out to be the culprits in a compliance-related scandal'.¹⁰² Although these advantages and disadvantages were postulated by Ho in relation to state-led corporate social responsibility, they may be applied to the state-led stakeholder model of corporate governance in China, given the blurred boundary between the two spheres on this model.

China's new state-led stakeholder approach to corporate governance has certainly reflected some of the positive aspects of the model articulated by Ho. As the review of the literature on the more recent governance practices in listed SOEs in section 9.2 suggested, the areas that have achieved greater formal and structural changes, such as corporate information disclosure, tend to coincide with increased government regulation in those areas.

The strong capacity of this model to bring about rapid formal and structural changes was also reflected in the government's handling of the milk scandal aftermath. At the exposure of the scandal, the central government responded quickly by utilising a multitude of formal and informal tools to strengthen the governance of the dairy companies and to enforce their 'social responsibilities' towards their injured stakeholders, such as the tort victims and trade creditors. Indeed, apart from the measures discussed in this chapter, many other mechanisms, ranging from swift criminal conviction of melamine producers, milk station operators and the Sanlu executives, to tightening up food standards, have been adopted by the central

¹⁰⁰ Ibid 434.

¹⁰¹ Ibid 435-6.

¹⁰² Ibid 414.

government to achieve these purposes.¹⁰³ Nor did the 10,000 Sanlu employees miss out. As the Party Secretary of Sanlu declared, “whoever wants to buy Sanlu must also take Sanlu’s employees”.¹⁰⁴ Hence, with the decisive and prompt response of the state, the various stakeholder interests were accommodated in the scandal aftermath. As such, social stability was maintained, and disruption to economic growth was kept to the minimum.

However, the disadvantages of the state-led stakeholder approach to the fostering of good governance practice in China were also quite evident in the central and local government’s handling of the milk scandal. Firstly, as mentioned earlier, strong state involvement in corporate affairs may limit the role played by market forces, including private sector organisations, in monitoring corporate governance. As the previous three chapters have argued, these forces have been introduced by the state to reform corporate governance in listed SOEs in China. Unfortunately, strong state intervention motivated by other higher ranking policy goals in the handling of the scandal did not allow the benefits of those forces to be exploited. This was despite the extensive coverage of the scandal in the commercial media and social websites, which probably contributed to the government’s adoption of the compensation plan for tort victims. While the early response from Fonterra to Sanlu’s contaminated milk incident was cooperative, the silence maintained by the Chinese semi-government, semi-not-for-profit organisations, such as the stock exchanges and consumer protection associations, was rather striking.

Secondly, the competing policy goals of the state in promoting economic development and maintaining social stability and good corporate governance may render it a less rigorous guardian of corporate governance. As the examination of the governance practices in large listed SOEs prior to 2005 in Chapter 4 suggested, the overlapping roles of the state as a controlling shareholder, corporate regulator, and promoter of stock market had played a major part in the lack of internal and external monitoring of the exercise of corporate powers by senior executives and parent SOEs. These overlapping and conflicting roles of the state have arguably become more complex under the new state-led stakeholder model of corporate governance, given the much wider range of

¹⁰³ ‘党中央国务院严肃处理三鹿奶粉事件相关责任人员’ [Central Party Committee and State Council Dealing with Persons Involved in the Sanlu Milk Scandal Seriously], above n 54.

¹⁰⁴ ‘三鹿党委书记：想买三鹿必须接受全部职工’ [Sanlu Party Committee Secretary: Whoever Wants to Buy Sanlu Must Also Take Sanlu’s Employees] *Xinhua Net News Story* (11 January 2009) <http://news.xinhuanet.com/local/2009-01/11/content_10638134.htm>.

interests it attempts to accommodate. In the aftermath of the scandal, the Chinese governments, at both central and local levels, were clearly mindful of their overriding roles in driving China's economic growth and social stability, and appeared to have been swayed by those considerations in dealing with issues of corporate governance including corporate social responsibility. As such, many laws, such as those in relation to consumer protection, enterprise bankruptcy, civil procedure and the company law were left unenforced, which inevitably undercut their rigor in deterring corporate misconduct. In relation to the executives of the dairy companies implicated in the scandal, so far, only the Chairperson and several other executives of Sanlu have been prosecuted. They were convicted for 'producing and selling fake or defective products' (rather than the more serious charge of 'producing and selling poisonous food products' for which the maximum penalty is death) under the PRC *Criminal Law*.¹⁰⁵ In the absence of a special investigation similar to an Australian-style royal commission inquiry, questions regarding the adequacy of internal controls in those companies and the attribution of fault to the persons involved will remain unanswered.

Nevertheless, among all the disadvantages associated with the state-led model, diminishing public trust in the importance of the rule of law and corporate social responsibility is probably most dangerous. The mixed message sent by the state in its administrative handling of the scandal aftermath has obviously contributed to this mishap. The expansive measures adopted by the central and local governments in rescuing Sanlu and other dairy companies, ranging from government-negotiated takeover of Sanlu to the state-sponsored media campaign to restore consumer confidence in domestic dairy products, do not signify the importance of compliance with the minimum requirement of the law, let alone corporate social responsibility that often goes beyond the limits of law.

Indeed, the Chinese government's swift handling of the 2008 milk scandal has not helped to reduce the number of corporate scandals in China. A series of other dairy incidents (such as the 'leather milk scandal',¹⁰⁶ and the aflatoxin M1-tainted milk

¹⁰⁵ '原三鹿集团董事长田文华一审被判处无期徒刑' [Former Sanlu Chairwoman Tian Wenhua Sentenced to Life Imprisonment], *Xinhua Net News Story* (22 January 2009) <http://news.xinhuanet.com/legal/2009-01/22/content_10701439.htm>; 《中华人民共和国刑法》 [Criminal Law of the People's Republic of China] (People's Republic of China) National People's Congress, 14 March 1997, arts 141, 144.

¹⁰⁶ Peter Foster, 'Top 10 Chinese Food Scandals', *The Telegraph* (online), 27 April 2011 <<http://www.telegraph.co.uk/news/worldnews/asia/china/8476080/Top-10-Chinese-Food-Scandals.html>>. The scandal, exposed in February 2011, involved dairy companies using leather-hydrolysed protein which, like melamine, artificially boosts the protein-content of milk. The scandal led the authority to close almost half of Chinese dairy companies in a bid to clean up the industry.

incident¹⁰⁷) have since occurred, exacerbating the lack of consumer confidence in Chinese infant formula.¹⁰⁸ In the meantime, food safety issues outside the dairy industry have become a central concern among Chinese consumers.¹⁰⁹ With the frequent exposure of food and other type of corporate scandals, such as corruption and major environmental pollution incidents, corporate social responsibility has remained a highly contentious issue in China.¹¹⁰ If allowed to grow, this type of public mistrust in corporate governance is not conducive to sustainable economic development and social stability.

The frequent exposure of scandals involving SOEs in recent years has also generated a new round of heated debate about future reform of the Chinese state sector. Various reform strategies have been proposed by commentators. These include depoliticising executive appointments in SOEs by recruiting top corporate executive from the market, increasing SOE transparency by bringing their budgets under the framework of the national budget, and reducing the monopoly of SOEs by shifting state-owned investments to not-for-profit sectors.¹¹¹ An even bolder strategy has been proposed by Professor Wang Yong, who suggests that to reinstate the concept of the 'SOEs-owned by the whole people' rather than by 'vested interests', revenues of SOEs should be put into designated pension funds to benefit the mass.¹¹² However, should China retain its current state-led model of economic development and the basic functions of SOEs under this model, future changes in the governance of SOEs are likely to take place in an incremental fashion at best.

¹⁰⁷ 'Questions Remain over Mengniu Milk Scandal, Experts Say', *Caixin* (online) (27 December 2011) <<http://english.caixin.com/2011-12-27/100343210.html>>. On December 2011, Mengniu Dairy Company Ltd. issued an announcement on its website, apologizing to consumers for aflatoxin M1- contaminated milk, which was spotted by the General Administration of Quality Supervision, Inspection and Quarantine in a recent sample survey of dairy products. Aflatoxin M1 is a liver cancer-causing agent.

¹⁰⁸ Rahul Jacob, 'Hong Kong Arrests Baby Milk Smugglers', *Financial Times* (online) (4 March 2013) <<http://www.ft.com/cms/s/0/9d6a35a8-84bb-11e2-aaf1-00144feabdc0.html#axzz2Nx0YnQgm>>.

¹⁰⁹ Foster, above n 106.

¹¹⁰ 万寿义, 刘正阳 [Wang Shouyi and Liu Zheng Yang], '交叉上市公司社会责任缺陷披露的市场反应' [Market Response to Disclosure of Breach of Corporate Social Responsibility by Cross-listed Companies] (2012) 1 中国人口资源与环境 *China Population, Resources and Environment* 62, 62.

¹¹¹ 胡舒立 [Hu Suli], '公司治理是硬道理' [Corporate Governance is the Way] *Caixin* (online) (19 September 2013) <<http://opinion.caixin.com/2013-09-22/100584491.html>>; Wang Yong, 'Taking SOEs Back to Their Roots' *Caixin Magazine* (online) 10 September 2013 <<http://english.caixin.com/2013-09-10/100580456.html>>.

¹¹² Wang Yong, 'Taking SOEs Back to Their Roots', *Caixin Magazine* (online) (10 September 2013) <<http://english.caixin.com/2013-09-10/100580456.html>>.

9.5 Conclusion

By contrast with the extensive changes in China's post-2005 regulatory framework for the governance of listed SOEs, changes to the underlying practices in these companies have been more limited. One important factor for the lack of substantial changes concerns the role of the state in the new state-led stakeholder model of corporate governance. As the literature on more recent governance practices in these companies and the involvement of the state in the handling of the 2008 milk scandal has suggested, this model has two main strengths. First, it enables the state to bring rapid formal or structural changes to Chinese corporate governance. Second, at times of major corporate crisis, it may serve as an efficient conflict management tool in support of economic growth and social stability. Nevertheless, these benefits are likely to be countered by the disadvantages of this model in fostering good governance practices in China.

As explained in this chapter, these disadvantages include the limited role played by non-state institutions in disciplining corporate governance, the potential lack of will and/or capacity of the state to maintain good corporate governance and the mixed messages it sends to the companies and society about the importance of compliance with law and corporate social responsibility. The competing goals of the state in promoting economic development, through preserving social stability, and in maintaining good corporate governance have underlined most of these disadvantages. As this chapter has demonstrated, in practice, a great deal of corporate governance in China may continue to rest upon the balance between the will and capacity of the state to balance its competing goals and the diverse interests within listed SOEs and the risk of lax internal controls that persists at the company level.

CHAPTER 10 CONCLUSION

10.1 Introduction

This thesis has demonstrated the emergence of a state-led stakeholder model of corporate governance through China's 2005 corporate law reform and the subsequent regulatory reforms. This chapter summarises the main findings of previous chapters, and reflects on their implications. It will begin with a summary of how the main research question has been addressed, through reviewing the answers to each set of subsidiary research questions developed in Chapter 1. The chapter will then link this study to the literature review (Chapter 2) to outline its contribution to knowledge. The limitations of this study, and directions for future research, will also be considered. This chapter will conclude by highlighting the main arguments of the thesis.

This chapter will show that this research makes a significant contribution to our understanding of not only Chinese corporate governance, but also comparative corporate governance and comparative capitalism more broadly. This is because it is the first comprehensive study of the governance of Chinese listed SOEs from the perspective of state capitalism and institutional change, and has articulated the state-led stakeholder model as a new state-led model of corporate governance.

10.2 Research questions and findings

As discussed in Chapter 1, the aim of this research was to offer a (re)interpretation of China's post-2005 legal and regulatory reforms concerning governance of listed SOEs, which constitute the main force of companies listed on the Chinese stock market. More specifically, it investigates and interprets the impact of state-led economic development on the evolution of law and practice in relation to three sets of company relations, namely, state-manager relations, investor protection and non-shareholder stakeholder (including employee) protection, in relation to listed SOEs prior to and after the 2005 corporate law reforms. As discussed in Chapter 3, these three sets of relations were central to the state-oriented or state-led model of corporate governance described by Hansmann and Kraakman¹ and the comparative capitalism literature (referred to as the

¹ Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439, 446-7.

'former state-led model' in this thesis).² The model was commonly adopted in the post-World War II state-led economies until the 1980s. As Chapter 5 discussed, this model was also reflected in the governance of listed SOEs in China prior to the 2005 corporate law reforms.

This research has been inspired by a perceived gap between two rapidly growing bodies of literature on China, namely, corporate governance and the Chinese model of economic development. On the one hand, China has been increasingly labelled as state capitalism, or a state-led economy, in political economic studies. On the other hand, despite the proliferation of analytical approaches, most existing studies on Chinese corporate governance have continued to use the Anglo-American outsider-based model as the benchmark to assess the governance of listed SOEs. In this second body of literature, China's 2005 overhaul of its decade old *Company Law*³ and the *Securities Law*⁴ was widely commended as having taken the Chinese systems of corporate law and corporate governance one step closer to the Anglo-American model. A systemic and in-depth analysis of the law and practice concerning the governance of listed SOEs, from the perspective of the Chinese state-led economic development, remains largely absent.

The analytical framework adopted in this research was state capitalism and institutional change. As discussed in Chapter 3, the framework was constructed by drawing upon (and extending) three interrelated strands of literature. These are comparative capitalism, comparative corporate governance, and law and capitalism, particularly, Milhaupt and Pistor's theorisation of the role of the state in shaping the interaction between changes in law, particularly the formulation and implementation of corporate law, alongside economic changes.⁵

² See, eg, Nahee Kang and Jeremy Moon, 'Institutional Complementarity between Corporate Governance and Corporate Social Responsibility: a Comparative Institutional Analysis of Three Capitalisms' (2012)10 *Socio-Economic Review* 85, 93-95; Jeremy Moon, Nahee Kang and Jean-Pascal Gond, 'Corporate Social Responsibility and Government in Western Europe and Northeast Asia from a National Governance Systems perspective' (International Centre for Corporate Social Responsibility Research Paper Series No. 56-2010) 11-13 <<http://www.nottingham.ac.uk/business/ICCSR/>>; Dirk Matten and Jeremy Moon, "'Implicit" and "explicit" CSR: a Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' (2008) 33 *Academy of Management Review* 404, 408.

³ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1993.

⁴ 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 29 December 1998.

⁵ Milhaupt and Pistor, *Law and Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World* (University of Chicago Press, 2008) 28.

10.2.1 The main research question and subsidiary research questions

The main research question of the thesis was *whether the law and practice concerning the governance of listed SOEs in China through the 2005 corporate law reforms and the relevant regulatory reforms suggest the rise of a new model of corporate governance*. To address this main research question, four sets of subsidiary research questions were also developed in Chapter 1:

1. Why did Chinese policy makers embrace the notion of corporate governance? What was the concept of corporate governance embraced by them?
2. What were the main features of and problems with corporate governance in listed SOEs prior to the 2005 corporate law reforms?
3. What are the major changes, and continuities, in the regulation of state-managers relations, investor protection and non-shareholder stakeholder protection since the 2005 major corporate law reforms? How can we interpret those changes, and continuities, from the perspective of state capitalism and institutional change?
4. What are the major changes, and/or the lack thereof, in relation to the underlying practice of corporate governance in listed SOEs post-2005? How can we explain the changes and/or the lack thereof?

Through addressing these subsidiary research questions in Chapters 4 to 9, this thesis argued that rather than China being a way station to the Anglo-American outsider-based model of corporate governance, a new model has emerged through hybridisation between the former state-led and prevailing international governance models, namely the Anglo-American outsider-based/shareholder model and the broader stakeholder model. This new model, which may be called a 'state-led stakeholder model', remains a state-centric one. It has, however, significantly moved away from the narrowly focused former state-led model. While state involvement in corporate decision-making remains at the core, it has intensified efforts to strengthen monitoring of managers, as well as to provide better protection to minority shareholders and other non-shareholder stakeholders such as employees, customers, suppliers and the community in which companies operate.

As expounded in this thesis, this shift, driven by the interaction between state power and strong international and domestic forces for change, has been better reflected in the law-

in-the-books, than the reality of corporate governance in listed SOEs post-2005. However, as long as China maintains its current form of state-led economic development, this new state-led stakeholder approach is likely to remain the dominant model of corporate governance in China for a long time to come. The answers to each set of the subsidiary research questions are summarised below, to illustrate these arguments of the thesis.

10.2.2 The first set of subsidiary research questions: the adoption of the concept of corporate governance in China

Comparative capitalism suggests that national systems of corporate governance are shaped by the economic purposes they are intended to serve. Hence, through examining the early stages of Chinese SOE reform, Chapter 4 analysed the purpose behind the official adoption of the concept of corporate governance in China, and the actual content of the concept embraced by Chinese policy makers.

As shown in Chapter 4, unlike in Anglo-American jurisdictions, where the purpose of corporate governance is to maximise financial returns for the shareholders, the official adoption of the concept in China was mainly driven by a need to improve the efficiency of SOEs through better management. The notion was officially introduced into the country through a document of the Chinese Communist Party (the Party) on the reform and development of SOEs in 1999,⁶ when a number of other measures to improve SOE performance (running from expanding decision-making rights of SOE managers, corporatisation and partial listing to the formation of large corporate groups) had been implemented, but achieved only limited success.

Chapter 4 also highlighted that the actual content of the concept, as contained in the 1999 policy document,⁷ was quite different from the standard Anglo-American version. The concept was of two two-fold. First, it was not aimed at removing state control of corporatised SOEs, particularly the large ones considered to be strategic by the state. Second, the concept was mainly concerned with improving the management of SOEs through solving the agency problem between the state, as the controlling shareholder, and corporate managers. In contrast, it paid scant attention to other agency problems which underpin the Anglo-American concept of corporate governance, such as those

⁶ 《中共中央关于国有企业改革和发展若干重大问题的决定》[Decision of the Central Committee of the Chinese Communist Party on Several Major Issues Concerning the Reform and Development of State-owned Enterprises], Adopted at the Fourth Plenum of the 15th Central Committee of the Chinese Communist Party, 22 September 1999.

⁷ Ibid.

between the managers and shareholders as a whole and between the controlling and minority shareholders.

China's post-2005 regulation of corporate governance in listed SOEs, as examined in Chapters 6 to 8, suggests that this concept has evolved over the years since its first adoption. The concept has been enlarged with the introduction of more investor and stakeholder-friendly rules and guidelines into the Chinese regulatory framework on corporate governance. However, the fundamental role of corporate governance as a tool to promote economic development has largely remained unchanged, and continued to align the governance of listed SOEs to a state-centric approach.

10.2.3 The second set of subsidiary research questions: features of and problems with governance of listed SOEs prior to 2005

These questions were designed to serve two main aims. The first was to test the applicability of the comparative capitalism theory on the interrelationship between state-led capitalism and state-led corporate governance to listed SOEs in China prior to its 2005 corporate law reforms. Second, it is believed that the various problems with corporate governance in listed SOEs during this period would inform subsequent legal and regulatory changes in the area. The latter were the subject of examination in the ensuing chapters. The examination of governance practice in listed SOEs prior to 2005 was based on original data collected from an Australian Research Council (ARC)-funded project, which focused on the corporate governance of China's top 100 listed companies. The overwhelming majority of these companies were, and remain, listed SOEs.

Chapter 5 found that China's pre-2005 regulation of corporate governance in listed SOEs resembled some key features of the former state-led model. Similar to that model, the Chinese framework emphasised the preservation of state control over corporate decision-making, but at the expense of the interests of minority shareholders and other non-shareholder stakeholders (except employees whose firm-specific skills and long-term commitments were considered as valuable assets to their companies). Indeed, the pre-2005 framework provided the state with multiple avenues to intervene in corporate affairs, but few enforceable rights and remedies to shareholders and other non-employee stakeholders.

Still conforming to the former state-led model, the governance practice in Chinese listed SOEs pre-2005, however, had some characteristics of its own. First, extensive

management powers vested in the general meeting and the Chairman of the board of directors, coupled with lax internal and external monitoring of the exercise of those powers, caused a dual problem of corporate governance in listed SOEs. That is, strong state intervention in corporate affairs co-existed with insider control by senior corporate executives and parent SOEs. As discussed in Chapter 5, this latter problem was manifested in the widespread presence of the 'key man' (or top executive in control) model of corporate governance in listed SOEs. This model not only led to managerial inefficiency, but also undermined the effectiveness of state control over listed companies.

Second, the exploitation of minority shareholders by controlling shareholders and senior managers appeared to be far more common and much worse in Chinese listed SOEs, compared with large companies in the former state-led economies such as Japan prior to the 1990s. The lack of investor protection was particularly manifested in poor information disclosure and rampant diversion of company funds by controlling shareholders through, among other means, related party transactions. As discussed in Chapter 5, a number of factors had contributed to these problems. These include the highly concentrated shareholding structure in listed SOEs, and the extremely weak regulatory regime on investor protection. The adverse impact of these factors was further exacerbated by the overlapping and conflicting roles of the state as the controlling shareholder, a regulator of the stock market and adjudicator of securities-related private lawsuits.

Similar to the former state-led model, stakeholder protection in listed SOEs was largely confined to the promotion of employee welfare. Prior to the 2005 corporate law reforms, the concept of corporate social responsibility was hardly embedded in the governance practice in these companies.

10.2.4 The third set of subsidiary research questions: changes and continuities in the regulation of state-manager relations, investor and other stakeholder protection post-2005, and how to interpret them

This set of subsidiary research questions lies at the heart of this research. Still focusing on the regulation of the above three sets of company relations in listed SOEs, and through examining the changes and continuities in China's post-2005 regulatory framework, Chapters 6 and 7 identified the emergence of a new state-led stakeholder model in the governance of listed SOEs.

This model can be distinguished from the former state-led model in the regulation of each of those three sets of relations. First, the state has intensified efforts to strengthen monitoring of managers. In doing so, many governance mechanisms of the Anglo-American outsider-based model have been introduced into not only listed SOEs, but also their parent SOEs. As Chapter 6 has demonstrated, some of these mechanisms place more checks and balances on the exercise of powers by top corporate executives. These include the board reform introduced through the 2005 *Company Law* and *Securities Law* and the ‘standardised board’ reform carried out by the State-owned Assets Supervision and Administration Commission (SASAC) towards central SOEs, the wholly state-owned parents of over 300, typically largest, listed companies in China. Other mechanisms provide directors with stronger incentives to maximise company financial performance (such as the introduction of equity-based incentive plans in listed companies and the performance-based executive remuneration schemes in central SOEs). Still other efforts, such as full listing of parent central SOEs, have been made to enlist outside investors and foreign stock market regulators to monitor and discipline SOE managers. In this respect, further steps along the lines of market-oriented reforms, such as establishing a number of state-owned capital operating companies to hold state shares in listed central SOEs, will no doubt lead state-manager relations in listed SOEs continue to shift away from the traditional state-led model which largely relied upon administrative control and supervision.

Second, in relation to the regulation of investor protection, this new state-led stakeholder model represents a far more investor-friendly approach than the Chinese pre-2005 framework, at least in regard to the law-in-the-books. This has been achieved mainly through drawing upon Anglo-American outsider-based corporate governance. As discussed in Chapter 7, while some of the market-based changes introduced by the 2005 *Company Law* and the *Securities Law* provide minority shareholders with greater opportunities to participate in corporate decision-making, others afford them with far better protection from abuse of power by corporate executives and controlling shareholders. In addition, an increased focus on investor confidence in the Chinese stock market has led the China Securities Regulatory Commission (CSRC) and SASAC to adopt many regulatory reforms in this area.

Third, increased monitoring of managers and legal protection of minority shareholders are, however, not all the changes that have taken place in the regulation of governance of listed SOEs post-2005. This new model draws upon the broader stakeholder model of

corporate governance. The level of emphasis on stakeholder protection/corporate social responsibility placed by China has, however, far exceeded their counterparts in most developed market economies. As discussed in Chapter 7, in addition to mandating corporate social responsibility through the 2005 *Company Law*, China has introduced many administrative regulations and guidelines in this area. These include compulsory disclosure of corporate social responsibility performance for certain types of listed companies and all central SOEs.

Nevertheless, rather than moving towards any of the prevailing international governance models, an equally striking feature of the Chinese post-2005 regulation of corporate governance is the ongoing state control over all three sets of company relations. First, the various market-oriented reforms on state-manager relations described above are unlikely to extinguish state control over corporate affairs. Various channels for state involvement in the management of listed companies are likely to persist, notwithstanding these market-oriented changes. As discussed in Chapter 6, these channels include ongoing ownership control of large and strategic SOEs by the state, Party/government control of key personnel appointments in SOEs, SASAC's extensive administrative powers over listed SOEs and other legal channels for state involvement in companies that remain available under the new *Company Law*.

Further, state control of company relations with their shareholders and other non-shareholder stakeholders has been manifested in ongoing state restraint of shareholder and other stakeholder activism, especially organised activism, in corporate governance. As discussed in Chapter 7, few of the post-2005 legislative and regulatory reforms have led to a transfer of the ultimate control over corporate affairs from the state to individuals and private sector organisations. While there are various restrictions on the exercise of shareholders' and other stakeholders' rights introduced by the 2005 *Company Law*, their access to the judicial system is significantly limited by various obstacles that exist both within the corporate law and the court system.

Chapter 8 interpreted these changes and continuities in China's post-2005 regulation of corporate governance in listed SOEs as summarised above from the perspective of state capitalism and institutional change. As discussed in the chapter, rather than a greater embrace of any of the prevailing international governance models (including the Anglo-American outsider-based model), the rise of the state-led stakeholder model in China post-2005 was primarily driven by an urgent need to improve the coordinative capacity

of the state to maintain the Chinese form of state-led economic development amid changing international and domestic environments.

As discussed in Chapter 3, the former state-led model of corporate governance was closely associated with a state-led model of economic management and development, or state capitalism. Note however, state capitalism is not static. Institutional change, including corporate governance change, in state-led economies is shaped by the interaction between the role of the state and international and domestic forces for change, such as economic globalisation and the pluralisation of interests within domestic society.

As illustrated in Chapter 8, such pressures faced by China had become particularly intense by the early to mid-2000s. Globalisation and China's integration into the world economy with its accession to the WTO membership aside, mounting social tensions in domestic society have posed an additional threat for the Party-state to retain the Chinese state-led economic development model. These tensions were manifested in the rapidly widening wealth gaps among Chinese citizens, increasing environmental degradation, and corruption. They had grown out of the development-first approach China adopted since the late 1970s, and were further fuelled by a growing awareness of self-interests among ordinary Chinese citizens, due to a combination of factors such as economic globalisation, rapid domestic economic development and the arrival of the internet. Needless to say, SOEs, as the chief embodiment of the Chinese form of state-led economic development, are positioned at the centre of these tensions.

These internal and external pressures have been behind the various changes and continuities in China's post-2005 regulation of corporate governance in listed SOEs. As explained in Chapter 8, the ongoing state control over the regulation of all three sets of company relations is consistent with the centrality of the state in the Chinese form of state-led economic development. Meanwhile, the various international and domestic pressures for change have led the Party-state to adopt various tools to increase its coordinating capacity to a pro-growth environment, as well as to refract pressures from shareholders and other non-shareholder stakeholders for a more fundamental systemic change. Two sets of these tools have been highlighted by Milhaupt and Pistor in their analysis of the role of the state in conditioning legal changes with economic changes in state-led economies. These are the limitation of the contestability of the formulation and

enforcement of the law by outsiders (namely, groups less favoured by the state) and substitution of demand for legal change with extra-legal means, such as norms.⁸

Drawing upon, but extending Milhaupt and Pistor's analysis, Chapter 8 illustrated a third set of tools that have been utilised by Chinese policy makers in China's post-2005 reform of corporate governance. This set is found in market forces, including mechanisms of corporate governance in the Anglo-American outsider-based/shareholder model and international best practices, particularly the broader stakeholder model. The adoption of these forces has led the governance of listed SOEs to move from the former narrowly-focused state-led to its current state-led stakeholder approach, without a full convergence into any of the prevailing international governance models.

Indeed, as illustrated in Chapter 8, this shift in the regulatory approach to the governance of listed SOEs is consistent with Chinese policy makers' response to the increasing international and domestic pressures for change at the policy level. That is, the Party's vision to create a 'harmonious society' through a 'scientific development' approach that emphasises coordinated development between economy, society and the natural environment.

10.2.5 The fourth set of subsidiary research question: changes and the lack thereof in the governance practices post-2005 and how to interpret them

The examination of the changes and continuities in China's post-2005 regulation of corporate governance also requires us to consider the impact of those changes on the reality of corporate governance in these companies and the reasons behind the changes, and/or the lack thereof, in relation to the latter.

The review of more recent literature on the governance practices in Chinese listed SOEs in Chapter 9 suggested that China's extensive legal and regulatory reforms over the past few years have had only limited influence on the reality of corporate governance in these companies. Despite increased government regulation, the various pre-2005 governance problems associated with these companies, such as lax corporate internal controls, poor investor and other stakeholder protection, have continued to various extents. These findings in the literature were also confirmed by the case study of the government's involvement in the 2008 China melamine-tainted milk scandal.

⁸ Milhaupt and Pistor, above n 5, 27-31, 38-39.

Many factors may have contributed to this failure to achieve more dramatic changes. Drawing upon Ho⁹ and the Chinese central and local governments' handling of the aftermath of the 2008 milk scandal, Chapter 9 highlighted the various advantages, and more importantly, disadvantages of the state-led stakeholder model of corporate governance. In relation to the advantages, Chapter 9 showed that by using a multitude of tools, including compulsory regulation, this model has enabled the Party-state to bring about rapid formal and structural changes to the regulation of corporate governance in China. Furthermore, the state-led stakeholder model may serve as an effective and efficient conflict management tool in support of economic growth and social stability, particularly in times of major corporate crisis.

Nevertheless, these benefits of the state-led stakeholder model are likely to be compromised by a failure to foster good corporate governance practice. This failure, as illustrated in Chapter 9, is shown by the limited room allowed for non-state actors to play a role in monitoring corporate governance, the potential lack of will and/or capacity of the state in disciplining managers, and the mixed message it may send to the companies, and the wider society, about the importance of compliance with law and corporate social responsibility. The multiple and conflicting goals of the state in maintaining economic development, social stability and good corporate governance underpin most of this failure. As such, while this new state-led stakeholder model has served significant policy goals, a great deal of corporate governance in China continues to hang on the balance between the will and capacity of the state to adjust its competing goals and the increasingly diverse interests involved in SOEs, and the risk of lax internal controls that persists at the company level.

10.3 Contribution to knowledge

As the first study of corporate governance in Chinese listed SOEs from the perspective of state capitalism and institutional change, the articulation of the state-led stakeholder governance model in this thesis contributes to three areas of research, which are outlined below.

⁹ Virginia Harper Ho, 'Beyond Regulation: A Comparative Look at State-Centric Corporate Social Responsibility & the Law in China' (2013) 46 *Vanderbilt Journal of Transnational Law* 375.

10.3.1 Contribution to studies of Chinese corporate governance

First, the state-led stakeholder model provides an alternative framework to interpret not only the various contradictions as manifested in the governance of Chinese listed SOEs, but also its future trend of development.

As discussed in Chapter 1, the governance of listed SOEs in China has been seen as being riddled with contradictions in current studies of corporate governance. Although the formal law is quickly converging towards the Anglo-American outsider-based model, the underlying practice has remained an insider-based system, with state-appointed top corporate executives exercising the real control over these companies. In relation to the future trend of development, a popular assumption underlying most current studies is that the governance of Chinese listed SOEs is, or should be, converging with the Anglo-American model. For many of these researchers, China's 2005 revision of its decade-old *Company Law* and the *Securities Law* represents a major step forward along this path. The various deficiencies/impediments both within and outside corporate law (such as political, ideological and cultural factors) have, however, prevented China from moving towards the Anglo-American model at a faster pace.

The state-led stakeholder model expounded in this thesis may be used to explain these contradictions between the law and practice in relation to the governance of listed SOEs in China. This study has shown that changes in the regulation of governance of listed SOEs post-2005 have been extensive and multi-dimensional. They however remain a state, rather than shareholder-oriented focus. Taken together, these changes have been introduced to strengthen, rather than to weaken, the effectiveness of state control over these large companies.

As discussed in Chapter 9, this new model has not achieved all of its intended purposes, particularly the purpose of strengthening internal control in listed SOEs. However, as long as China maintains its current form of state-led economic development and the basic functions served by SOEs,¹⁰ the state is likely to continue to assume a dominant role in the future development of this model.

As such, foreign companies and investors dealing with Chinese SOEs should take note of the emergence of this model in China, and be prepared to interact closely with all actors involved in this model, especially the state as the leading actor.

¹⁰ This is likely given the emphasis placed by successive Chinese leaders on reform of SOEs as a way to enhance the state sector's vitality and capacity to leverage and influence the economy as discussed in Chapter 2.

10.3.2 Contribution to comparative corporate governance research

By presenting new evidence on the resilience of state-led corporate governance, the articulation of a hybrid state-led stakeholder model of corporate governance in China also contributes to research on comparative corporate governance. According to commentators such as Hansmann and Kraakman,¹¹ strong forces of globalisation and competition and the rise of the shareholder class (as the predominant interest group) will compel world corporate governance models, including the former state-led model, to converge onto one single best model, namely the Anglo-American outsider-based/investor-oriented model.¹²

The rise of the state-led stakeholder model in China through its post-2005 regulation of corporate governance in listed SOEs, however, suggests an alternative path for the evolution of the former state-led model. Faced with strong international and domestic forces for change, this model may choose to respond by readjusting its relations with pre-existing key corporate actors, as well as taking into account the interests of other emerging actors, rather than converging into any of prevailing international governance models.

This state-led stakeholder model is far from an ideal model to researchers acquainted with the Anglo-American outsider-based corporate governance. This is despite the increased legal protection it offers investors compared to the former state-led model. The all-encompassing approach this model adopts inevitably increases the uncertainty for public investors as minority shareholders of listed companies. These investors now have to compete with a plethora of other vested interests in Chinese listed SOEs, and they can never be certain where theirs are located in the government/company's list of priorities in a given circumstance. As the case study on the central government's handling of the 2008 milk scandal suggested, instead of investors alone, the relevant importance attached by the state to each type of company stakeholder interests is often dictated by the prevailing pressure(s) faced by the state.

However, comparative corporate governance researchers should perhaps accept this new model as it is, and be more prepared to grapple with the diverse purposes served by corporate governance in different economic systems. This is especially so in the light of the rethinking of corporate governance triggered by the recent Global Financial Crisis

¹¹ Hansmann and Kraakman, above n 1, 449.

¹² Ibid 450-3.

(GFC). As pointed out by Clarke, the GFC has not only rendered the prospect of convergence in national corporate governance systems rather uncertain, but also ‘called into question many of our traditional ways of thinking about corporate governance and the relationship between business enterprises and the state’.¹³ Indeed, the need to understand better the diverse purposes served by corporate governance has also been highlighted by a number of recent studies that reflect on corporate governance implications of the fast expansion into foreign markets, particularly markets for corporate control, by sovereign investment funds and SOEs including Chinese SOEs.¹⁴

10.3.3 Contribution to state capitalism literature

Through examining the impact of the Chinese form of state-led capitalism on the governance of large listed SOEs in China, this thesis contributes to the varieties of capitalism literature in two aspects. First, by contextualising the recent evolution of Chinese corporate governance law and practices in its state-led economic development, this thesis has presented new evidence of the interrelationship between national models of corporate governance and economic models. As discussed in Chapter 3, in relation to state-led economies, this strand of analysis has been mainly based upon experiences of the former post-war state-led economies, such as France and the East Asian developmental states.

Second, by identifying an alternative analysis of the evolution of state-led corporate governance that is taking place in China, this thesis may further inform research on comparative capitalism and institutional change. As illustrated in Chapter 3, with its emphasis on ‘institutional complementarities’ and ‘comparative institutional advantages’, the varieties of capitalism, represented by Hall and Soskice,¹⁵ has been criticised for its failure to provide a satisfactory account for institutional change.¹⁶

¹³ Donald Clarke, ‘Nothing but Wind? The Past and Future of Comparative Corporate Governance’ (2011) 59 *American Journal of Comparative Law* 75, 76-77.

¹⁴ See, eg, Larry Cata Backer, ‘Sovereign investing in Times of Crisis: Global Regulation of Sovereign Wealth Funds, State Owned Enterprises and the Chinese Experience’ (2010) 19 *Transnational Law & Contemporary Problems* 3; Ronald Gilson and Curtis Milhaupt, ‘Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism’ (2008) 60 *Stanford Law Review* 1345; Geoffrey Nicoll, Gerard Brennan and Keni Josifoski, ‘The New Mercantilism? –Direct Investment by State-owned Enterprises in Australian Public Companies’ (2012) 40 *Australian Business Law Review* 105.

¹⁵ Peter Hall and David Soskice, ‘An Introduction to Varieties of Capitalism’ in Peter Hall and David Soskice (eds), *Varieties of Capitalism: the Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001) 1.

¹⁶ Gregory Jackson and Richard Deeg, ‘How Many Varieties of Capitalism: Comparing the Comparative Institutional Analyses of Capitalist Diversity’ (MPIFG Discussion Paper No. 06/2, April 11, 2006) <<http://ssrn.com/abstract=896384.5>>; Nick Wailes, Jim Kitay and Russell D. Lansbury, ‘Varieties of Capitalism, Corporate Governance and Employment Relations Under Globalisation’ in Shelley Marshall, Richard Mitchell

Drawing upon, but extending Milhaupt and Pistor's law and capitalism analysis,¹⁷ this thesis has revealed system hybridisation as a possible pattern for the evolution of state-led corporate governance, as a particular set of institutions, in state-led economies. While providing a theory on state capitalism and institutional change is not an objective of this study, the analysis in this thesis of the evolution of law and practice concerning the governance of listed SOEs in China over the past ten years may help to prompt further research into this subject.

10.4 Limitations of this study and directions for further research

This thesis has aimed at exploring a conceptual model of corporate governance, as reflected in the evolution of law and practice concerning the governance of Chinese listed SOEs, before and after the 2005 major corporate law reforms. This focus necessitated that the study mainly focused on the principles and arrangements of corporate governance at national level, rather than at local levels. Furthermore, in considering the governance practices of listed SOEs, this thesis has focused more on broad trends rather than detailed discrepancies in individual companies across different industries and localities. Given the large number of listed SOEs and significant sectoral and regional differences in China, it is understandable that corporate governance arrangements and practices in each listed SOE are likely to be more dynamic than the stylised account provided in this thesis.

The articulation of the state-led model of corporate governance in China, as well as the limitations of this study, may inform research into three areas. First, future research can be directed to test the applicability of this state-led stakeholder model within individual listed SOEs in China. This may be carried out through case studies involving a number of listed companies from various industries and localities in China.

Second, future research may be directed towards the application of this model to overseas subsidiaries of Chinese SOEs. This thesis has focused on corporate governance of SOEs listed on the Chinese domestic stock market, although a growing number of these companies have also become cross-listed overseas, including Hong Kong. In view of the vast differences in the systems of corporate law and corporate governance in different jurisdictions, future research into the governance of the overseas subsidiaries

and Ian Ramsay (eds), *Varieties of Capitalism, Corporate Governance and Employees* (Melbourne University Press, 2008) 19, 27.

¹⁷ Milhaupt and Pistor, above 5, ch 2.

of Chinese SOEs, will help to provide some insights into the interaction between the Chinese state-led stakeholder model and other corporate governance models, particularly the Anglo-American outsider-based model. In this respect, the increased presence of Chinese SOEs in the Australian corporate landscape in the past few years provides a valuable ground for empirical research. In view of the fast growing trade and investment relations between the two countries, research into this area will have not only academic, but also practical, significance.

Finally, future research could also be directed to test the applicability of the state-led stakeholder model to corporate governance in large Chinese listed companies in the private sector. The state-led stakeholder model articulated in this thesis has been based on the law and practice concerning corporate governance in listed SOEs or state-controlled listed companies. However, this model may have some relevance to privately-controlled listed companies in China due to at least two reasons. First, most of the post-2005 legal and regulatory changes discussed in this thesis, including the strengthened presence of the Party within companies,¹⁸ apply to all Chinese companies irrespective of ownership types and structures. Second, as shown in Chapter 2, the Chinese form of state capitalism has been mainly reflected in state ownership and support of large SOEs. There is, however, some evidence of state promotion of economic development through supporting large privately controlled companies, especially at local government levels.¹⁹ Indeed, the relationship between the Chinese government and private companies has become a rather sensitive issue, which was reflected in the recent US congressional investigation into Huawei and ZTE Corporation, two large Chinese private telecommunication companies tapping into international markets.²⁰ This trend of the state association with private businesses is likely to continue. This is because, as mentioned earlier, the recent slowing down of the Chinese economy has prompted policy makers to look for new areas of economic growth. Empirical studies into the applicability of the state-led stakeholder model to the governance of these companies will, therefore, help to explore the role of the state in the governance of large private companies in China.

¹⁸ 《中华人民共和国公司法》 [Company Law of the People's Republic of China] (People's Republic of China) National People's Congress Standing Committee, 27 October 2005, art 19.

¹⁹ See, eg, Alexius A. Pereira, *State Collaboration and Development Strategies in China: The Case of China-Singapore Suzhou Industrial Park* (1992-2002) (RoutledgeCurzon, 2003); Margaret Pearson, *China's New Business Elite, The Political Consequences of Economic Reform* (University of California Press, 1997)

²⁰ Jim Wolf, 'U.S. Law Makers Seek to Block China Huawei, ZTE U.S. Inroads' *Reuters* (online), 8 October 2012 <<http://www.reuters.com/article/2012/10/08/us-usa-china-huawei-zte-idUSBRE8960NH20121008>>.

10.5 Conclusion

Consistent with the widely assumed supremacy of the Anglo-American model of corporate governance, at least until the recent GFC, studies of Chinese corporate governance have mainly focused on how that model could be emulated to improve governance of Chinese companies. Instead of China moving towards the Anglo-American model, this thesis has articulated the rise of a state-led stakeholder model of corporate governance in Chinese listed SOEs. This has been undertaken through examining the changes, and continuities, in the Chinese post-2005 regulation of three sets of company relations, namely, state-manager relations, investor protection and other stakeholder (including employee) protection, in listed SOEs through the prism of state capitalism and institutional change.

Similar to the governance of listed SOEs pre-2005 (which reflected some key features of the former state-led model of corporate governance commonly adopted in the early post-World War II state-led economies), state control of corporate affairs remains at the heart of this new state-led model. This model has, however, been considerably modified towards a broader stakeholder approach that pays equal attention to ultimate state control and the coordinative capacity of the state to adjust company relations with their internal and external stakeholders including, but not limited to, minority shareholders and employees. This model has both benefits and disadvantages to the promotion of economic development and good corporate governance in China. However, due in part to its general congruence with the Chinese form of state-led economic development, the continued evolution of the model is likely to be incremental at best. As such, the articulation of this new governance model makes a significant contribution to our understanding of not only corporate governance in Chinese listed SOEs, but also studies of comparative corporate governance and comparative capitalism more broadly.

Appendix 1-1 Fortune Magazine sample of top 100 Chinese listed companies (2001–2004)

Listed company	Rank				
	2004	2003	2002	2001	2012
China Petroleum & Chemical	1	1	1	1	1
PetroChina	2	2	2	2	2
China Mobile (Hong Kong)	3	3	3	3	3
China Telecom	4	4	-	-	15
China Life Insurance Company Limited	5	-	-	-	10
China Unicom	6	5	4	6	18
PICC Property and Casualty Company Limited	7	-	-	-	25
Minmetals Townlord Technology	8	8	11	16	-
Baoshan Iron & Steel	9	6	5	4	17
CNOOC	10	9	8	-	20
China Resources Enterprise	11	7	7	9	46
Sinopec Shanghai Petrochemical	12	11	9	8	39
Sinopec Zhenhai Refining & Chemical	13	12	10	7	-
TCL Corporation	14	-	-	-	76
CITIC Pacific	15	10	12	10	54
Legend Group	16	13	6	5	21
Huaneng Power International Holdings	17	15	15	14	26
Aluminum Corp. of China	18	17	14	-	24
Sinopec Yangzi Petrochemical	19	18	17	11	-
Jilin Chemical Industrial	20	24	19	13	-
Bank of China Hong Kong Holding	21	14	-	-	12
Sinotrans Limited	22	-	-	-	113
China Southern Airlines	23	16	13	12	43
Shanxi Taigang Stainless Steel	24	32	42	56	37
UTStarcom	25	44	67	-	-
TCL International Holdings	26	21	22	21	76
Shenzhen Zhongxing Telecom	27	28	26	62	49
Maanshan Iron & Steel	28	29	23	27	48
Beijing Shougang	29	23	18	15	293
AviChina Industry & Technology Company Limited	30	-	-	-	278
COFCO International	31	26	47	-	72
Angang New Steel	32	31	25	19	44
Chongqing Chang'an Automobile	33	33	36	38	164
Digital China Holdings	34	20	27	-	85
Tangshan Iron & Steel	35	36	31	35	-
Sichuan Changhong Electric	36	22	24	18	92
China Eastern Airlines	37	19	16	17	50
Beiqi Futian Vehicle	38	55	79	90	93

Listed company	Rank				
	2004	2003	2002	2001	2012
China International Marine Containers Group	39	37	43	25	160
Guangdong Midea Holding	40	30	21	26	42
China Merchant Bank	41	25	-	-	38
Konka Group	42	47	44	23	237
Hunan Valin Steel Tube & Wire	43	34	29	45	61
Handan Iron & Steel	44	51	37	46	-
China Minsheng Banking	45	59	68	-	53
Shanghai Pudong Development Bank	46	43	38	48	71
China Aviation Oil (Singapore)	47	45	71	-	-
Qingdao Haier Holdings	48	27	20	57	62
Shanghai Friendship Group	49	54	58	-	106
Sinopec Beijing Yanhua Petrochemical	50	35	55	28	-
Bengang Steel Plates	51	81	64	34	100
BOE Technology Group	52	87	-	-	284
Great Wall Technology	53	40	57	42	40
Jinzhou Petrochemical	54	39	28	22	-
Sinochem International	55	50	48	50	82
Shanghai Construction	56	38	32	29	52
Laiwu Steel	57	74	70	61	-
Ningbo Bird	58	72	-	-	-
Inner Mongolia Baotou Steel Unicom	59	70	59	-	117
Sinopec Yizheng Chemical Fibre	60	49	33	24	203
Torch Investment Co., Ltd.	61	-	-	-	-
Brilliance China Automotive Holdings	62	57	53	44	484
Gree Electric Appliances of Zhuhai	63	62	46	43	51
Beijing Datang Power Generation	64	48	49	49	63
Shanghai Pharmaceutical	65	58	65	59	84
FAW Car	66	91	97	95	140
Qilu Petrochemical	67	60	40	33	-
Anyang Iron & Steel	68	67	56	-	152
Panzhuhua New Steel & Vanadium	69	53	35	31	89
Xiamen C&D	70	56	54	54	57
Yanzhou Coal Mining	71	46	50	58	103
Beijing Enterprises Holdings	72	63	45	51	172
Huaxia Bank Co., Ltd.	73	-	-	-	137
Sinopec Kantons Holdings	74	68	52	20	241
China Overseas Land & Investment	75	71	41	39	121
Huadian Power International Corporation Limited	76	52	39	37	358
Shenzhen Kaifa Technology	77	73	85	73	60
Tsingtao Brewery	78	65	63	85	183
Hangzhou Iron & Steel	79	82	77	70	189
Henan Shuanghui Investment & Development	80	90	-	-	125
SGIS Songhan	81	-	84	89	185

Listed company	Rank				
	2004	2003	2002	2001	2012
Nanjing Textiles Imp & Exp Corp., Ltd.	82	-	-	-	-
Guangzhou Pharmaceutical	83	75	62	67	-
Harbin Pharmaceutical Group	84	69	61	41	269
Shanghai Automotive	85	89	92	-	8
Shanghai Material Trading Center	86	98	-	-	56
Nanjing Iron & Steel	87	92	82	88	123
Amoisonic Electronics	88	97	-	-	-
Wuhan Steel Processing	89	66	51	36	35
Tsinghua Tongfang	90	80	69	91	-
Lianyungang Ideal Group	91	95	-	-	143
Guangzhou Iron & Steel Co., Ltd.	92	-	-	-	-
Weiqiao Textile Company Limited	93	-	-	-	245
China Vanke	94	94	74	71	64
Yibin Wuliangye	95	76	72	69	202
Inner Mongolia Yili Industry Group Co., Ltd.	96	-	-	-	128
Guangdong Kelon Electrical Holdings	97	86	73	72	218
Guangdong Electric Power Development	98	78	60	65	255
Shijiazhuang Refining-Chemical	99	88	66	47	-
Shenzhen Development Bank	100	79	76	-	153
TCL Communications Equipment	-	41	-	-	388
Eastern Communications	-	42	30	30	-
Guangdong Investment	-	61	34	53	-
Dongfeng Automobile	-	64	75	86	194
Hisense Electric	-	77	88	64	218
People's Food Holdings	-	83	78	-	-
Hainan Airlines	-	84	-	-	165
Shanghai Bright Dairy & Food	-	85	-	-	306
SVA Electron	-	93	80	55	-
Shanghai Founder Yanzhong Sci. & Tech.Group	-	96	93	-	498
Shanghai Electric	-	99	90	77	70
Shandong Chenming Paper Holdings	-	100	-	-	223
China Railway Erju	-	-	81	-	79
Shanghai Tunnel Engineering	-	-	83	-	261
Guangzhou Development Industry Holdings	-	-	86	83	333
China Shipping Development	-	-	87	93	295
Shanghai Shenhua Industrial	-	-	89	-	340
Chongqing Iron & Steel	-	-	91	75	180
Ningbo United Group	-	-	94	-	-
China Resources Land	-	-	95	-	154
Guangzhou Investment	-	-	96	80	366
Gansu Jiugang Group Hongxing Iron & Steel	-	-	98	97	83
Shanghai Industrial Holdings	-	-	99	96	277
Qingling Motors	-	-	100	63	399

Source: Roman Tomasic and Neil, Andrews, 'Minority Shareholder Protection in China's Top 100 Listed Companies' (2007) 9 *Australian Journal of Asian Law* 88, 94; The 2012 ranking of these companies is from Fortune Magazine (Chinese edition) China's Top 500 Listed Companies in 2012. <http://www.fortunechina.com/fortune500/node_4302.htm >

City	Executives of listed companies	Professors and academics	Entrepreneurs	Students
Beijing	17	12	3	42
Shanghai	16	8	16	23
Hong Kong	7	2	8	20
Shenzhen	7	2	1	15
Qingdao	4	1	1	4
Jinan	3	1	1	3
Chengdu	2	1	1	2
Nanjing	2	1	1	2
Guangzhou	2	1	1	2
Subtotal	68	37	33	108

Source: Roman Tomasic and Neil, Andrews, 'Minority Shareholder Protection in China's Top 100 Listed Companies' (2007) 9 *Australian Journal of Asian Law* 88, 94

Appendix 1-2 The ARC project interviews—numbers of interviews by position of interviewees and location

City	Executives of listed companies	Professionals and academics	Regulators	Subtotal
Beijing	17	12	3	32
Shanghai	19	8	5	32
Hong Kong	7	7	6	20
Shenzhen	7		3	10
Qingdao	4			4
Jinan	3			3
Chongqing	2			2
Nanjing	2			2
Guangzhou	2		1	3
Subtotal	63	27	18	108

Source: Roman Tomasic and Neil, Andrews, 'Minority Shareholder Protection in China's Top 100 Listed Companies' (2007) 9 *Australian Journal of Asian Law* 88, 94

Appendix 1-3 The ARC project interview schedule

CONCEPTS

1. Corporate governance means different things to different people; what would you see as being at the heart of this idea? ^{*1}
2. Why is corporate governance so important in your view?
3. Generally speaking, corporate governance is increasingly seen as an important issue for listed companies; of the top 10 issues that are important to your company, where would you place corporate governance?*
4. In regard to the controllers of Chinese listed companies, in your experience, would you say that they would generally see corporate governance as being as important as you do?
5. Within a Chinese listed company there are different levels of understanding of corporate governance principles; how well do you think that Board members of these listed companies understand such principles?*
6. How would you describe the understanding of corporate governance principles held by others such as:
 - a) the Chairman?
 - b) the General Manager?
 - c) Members of Supervisory Boards*
7. In your experience are directors able to assess:
 - a) what information needs to be disclosed?
 - b) what related party transactions are?
 - c) what would be an unacceptable level of risk?

¹ Questions marked with an asterisk (*) are questions directly relevant to the research in this thesis.

STAKEHOLDERS

8. In regard to PRC Listed companies, what would you see as being their most important stakeholders (from most important to least)?*
9. How much interest do you think shareholders in PRC listed companies have in corporate governance principles?*
10. Would you say that any particular class of shareholders has a disproportionately strong belief in the importance of good corporate governance? (PROBE: If so, why?)
11. Some would say that the protection of minority shareholders is an important feature of good corporate governance. Would you agree with this? (PROBE: If so, why?)
12. How have minority shareholder interests usually been protected in PRC listed companies, if at all?*
13. It is often said that the protection of the interests of employees is also a fundamental concern of good corporate governance. Would you say that this is true in most PRC listed companies? (PROBE: If it is, in what way?)*
14. The 16th Party Congress of the CCP recently welcomed entrepreneurs into the Party; do you think that this decision will have a significant effect on corporate governance practices in PRC listed companies?
15. How do you see the old practices of governance being reconciled within PRC listed companies? (some speak of the system of three vs three)
16. In Australia, unions have sometimes played an important role in protecting the stakeholder interests of employees of listed companies (eg Ansett Airlines); would you say that Chinese unions have had a noticeable impact on the corporate governance practices of China's listed companies? (PROBE: If so, could you please illustrate)*

SHAREHOLDERS

17. It is well known that the State is a dominant shareholder in PRC listed companies. How, if at all, do you see this as affecting corporate governance practices in these companies?*
18. Would you say that the size of the majority shareholder's position in the company affects the degree of transparency that exists in such listed companies? (PROBE: could you please elaborate?)*
19. State owned shares are not generally readily transferable on the market (in China); in your experience, does this affect the degree to which managers and directors are responsive to issues that are not of concern to the dominant shareholder?
20. In Australia, directors are required by law to be concerned primarily with the interests of the company as whole (i.e. of all shareholders and other interests). Would you say that this occurs where a single shareholder owns 80 or 90% of a listed company's shares?*
21. In your experience of the annual general meeting of PRC Listed Companies are shareholders:
- a) given adequate information?
 - b) able to place appropriate matters on the agenda?
 - c) able to vote on appropriate issues?*

DIRECTORS AND OTHERS

22. What corporate governance role, if any, would you see "independent" or "outside" directors playing on the boards of PRC listed companies?*
23. Would you say that Board members of PRC listed companies are aware of their potential liability as directors of listed companies? (PROBE: would this also be the case with "independent" or "outside" directors?)*

24. In your experience, how easy is it for directors of PRC listed companies to take advantage of their positions as directors to make use of inside information? (PROBE: is this common?)*
25. In your experience, how aware would board members of PRC listed companies, that you know of, be of the financial and operational details of their companies?
26. Audit committees are often seen as an important means of monitoring company accounts; what role do you see such committees playing in the corporate governance practices of PRC companies that you know of?*
27. The recent collapse of Enron in the US showed that company financial officers play a crucial role in regard to the corporate governance fabric of companies; to what extent would this be so in PRC listed companies?
28. The company secretary is sometimes seen as the guardian of corporate governance within a company; how do you see the company secretary operating in the listed companies that you know?

REGULATION

29. In your experience, is the Stock Exchange an effective monitor of corporate governance practices?*
30. How might this regulatory role be improved, if at all?
31. Have the Stock Exchange Listing Rules affected practices of PRC Listed Companies? (PROBE: in what way?)*
32. In contrast, what effect would you see the CSRC's Code of Corporate Governance having on the day to day operations of listed company boards and their directors?*
33. We note that the CSRC has issued many rules and guidelines for companies. Do you think that China has an excessively legalistic approach to corporate governance?*
34. How flexible do you see the CSRC being in the application of its rules and regulations?*

35. Does the CSRC have the skills and knowledge to effectively regulate the corporate governance practices of PRC listed companies?*
36. Do you think that PRC listed companies can be trusted to apply corporate governance principles without strong external oversight from the CSRC or the Stock Exchange?

DISCLOSURE

37. Disclosure is often seen as a basic tool of good corporate governance as it fosters transparency and accountability; in your experience, how effective is the current system of corporate disclosure in regard to China's listed companies?*
38. In your experience, in what kinds of situations has the Stock Exchange expressed most concern about inadequate disclosure by PRC listed companies?*
39. Keeping shareholders and the market informed has been an important goal of disclosure. What difficulties do PRC listed companies face in being able to achieve this goal?*

ENFORCEMENT AND REMEDIES

40. In Australia, the regulator has frequently taken legal action against directors who have breached their legal duties; what obstacles to the adoption of a similar regulatory approach exist in China?*
41. Are directors who are appointed by the majority shareholder in China in a better position to protect themselves from such potential regulatory action?*
42. The absence of effective compensation and civil remedies against directors who breach their legal obligations may inhibit the availability of adequate accountability. Is this a problem in PRC companies, in your experience?*
43. Would the level of accountability within PRC listed companies increase if shareholders were able to bring actions in the name of the company against the company's own directors (ie derivative suits)?*
44. In your experience, does the listing of Chinese companies on foreign exchanges improve the quality of corporate governance practices in China? (PROBE: If so could you please illustrate?)*

45. Has the entry of foreign investors into the Chinese "A" share market (through the QFII program) lead to changes in corporate governance practices in China?*
46. Does listing on foreign exchanges, or the need for PRC Listed Companies to raise foreign capital, mean that PRC Listed Companies will have a similar governance structure and principles to foreign listed companies? (PROBE: If so could you please illustrate?)*
47. In your experience, do professional advisers (such as accountants, lawyers, etc) play an important role in corporate decision in PRC listed companies? (PROBE: could you please explain?)

Appendix 2-1 Top 100 Chinese listed companies in 2012 (ranked by market capitalisation)

Ranking	Company name
1	Petrochina Company Limited
2	Industrial and Commercial Bank of China Limited
3	China Construction Bank Corporation
4	Agricultural Bank of China Limited
5	Bank of China Limited
6	China Petroleum & Chemical Corporation
7	China Shenhua Energy Company Limited
8	China Life Insurance Company Limited
9	Ping An Insurance (Group) Company of China Limited
10	Bank of Communications Company Limited
11	China Merchants Bank Co., Ltd.
12	Kweichow Moutai Co.,Ltd.
13	China Pacific Insurance (Group) Company Limited
14	China CITIC Bank Corporation Ltd.
15	Yanzhou Coal Mining Company Limited
16	SAIC Motor Corporation Limited
17	China Minsheng Banking Co., Ltd.
18	Aluminum Corporation of China Limited
19	Industrial Bank Co., Ltd.
20	Shanghai Pudong Development Bank Co., Ltd.
21	China Everbright Bank Co.,Ltd.
22	China Coal Energy Company Limited
23	CITIC Securities Company Limited
24	China Shipbuilding Industry Company Limited
25	Air China Limited
26	Jiangxi Copper Company Limited
27	Daqin Railway Co., Ltd.
28	China State Construction International Holdings Limited
29	China Yangtze Power Co., Ltd.
30	China United Network Communications Limited
31	Baoshan Iron & Steel Co.,Ltd.
32	Zijin Mining Group Company Limited
33	GF Securities Co., Ltd.
34	Anhui Conch Cement Company Limited
35	Vanke Co., Ltd.
36	Sany Heavy Industry Co., Ltd.
37	Changsha in the Heavy Industry Technology Deveopment Co., Ltd.
38	Suning Appliance Co., Ltd.
39	Shanghai International Port (Group) Co., Ltd.
40	Shanghai Electric Group Company Limited
41	Inner Mongolia Baotou Steel Rare-earth (Group) Hi-tech Co., Ltd.
42	China Railway Group Limited
43	China COSCO Holdings Co., Ltd.
44	China South Locomotive & Rolling Stock Corporation Ltd.

Ranking	Company name
45	ZTE Corporation
46	China Oilfield Services Limited
47	China Southern Airlines Co., Ltd.
48	Shanxi Xishan Coal and Electricity Power Co., Ltd.
49	Weichai Power Co., Ltd.
50	Shanxi Lu'An Environmental Energy Development Co.,Ltd
51	Metallurgical Corporation of China Ltd.
52	China Railway Construction Corporation Limited
53	Haitong Securities Company Ltd.
54	Huaneng Power International Co., Ltd.
55	Huatai Securities Co., Ltd.
56	Datang International Power Generation Co., Ltd.
57	Gree Electric Appliances, Inc. of Zhuhai
58	China Merchants Securities Co., Ltd.
59	Shandong Gold Mining Co., Ltd
60	Pangang Group Vanadium Titanium and Resources Co., Ltd.
61	Luzhou Lao Jiao Co.,Ltd.
62	Guangzhou Media Co., Ltd.
63	Jinduicheng Molybdenum Co.,Ltd.
64	Bank of Beijing Co., Ltd.
65	Shenzhen Development Bank Co., Ltd.
66	China Eastern Airlines Corporation Limited
67	Jizhong Energy Resources Co., Ltd.
68	China International Marine Containers Group
69	Yangquan Coal Industry (Group) Co., Ltd.
70	Jiangsu Yanghe Brewery Joint-stock Co., Ltd.
71	China CNR Corporation Limited
72	Hua Xia Bank Co., Ltd.
73	Inner Mongolia Baotou Steel Union Co.,Ltd.
74	Yantai Chang Yu Pioneer Wine Company Limited
75	XCMG Construction Machinery Co., Ltd.
76	Dongfang Electric Corporation Limited
77	Poly Real Estate Group Co., Ltd.
78	Angang Steel Company Limited
79	China CSSC Holdings Limited
80	Everbright Securities Company Limited
81	Guanghui Energy Co., Ltd.
82	Tsingtao Brewery Co., Ltd.
83	GD Power Development Co., Ltd.
84	Qinghai Salt Lake Industry Co., Ltd.
85	China National Chemical Engineering Co., Ltd.
86	China Shipping Container Lines Company Limited
87	China Gezhouba Group Co., Ltd.
88	Ningbo Port Company Limited
89	Xinjiang Goldwind Science and Technology Co., Ltd.
90	Henan Shuanghui Investment and Development Co., Ltd.
91	Chongqing Water Group Co., Ltd.
92	Yunnan Baiyao Group Co., Ltd.
93	Zhongjin Gold Corp., Ltd.

Ranking	Company name
94	Industrial Securities Co., Ltd.
95	Qingdao Haier Co., Ltd.
96	Minmetals Development Co., Ltd.
97	Guizhou Panjiang Refined Coal Co., Ltd.
98	Western Mining Co., Ltd.
99	Meihua Holdings Group Co., Ltd.
100	CSG Holding Co., Ltd.

Source: Protiviti and Chinese Academy of Social Science, 《2012 中国上市公司一百强治理评价报告》 [Corporate Governance of Chinese top 100 Chinese Listed Companies 2012 Report] 30-31 <<http://www.protiviti.com/zh-CN/Pages/zh-CN-Corporate-Governance-Assessment-Summary-Report-on-the-Top-100-Chinese-Listed-Companies.aspx>>.

1990-1999	Establishment of Shanghai and Shenzhen Stock Exchanges
November 1991	Third Plenum of the 4 th CCP Central Committee passed Decision on Several Issues Concerning the Establishment of the System of Socialist Market Economy, which set the establishment of the market with state system as foundation for future SOE reform.
December 1993	Promulgation of the 1993 PRC Company Law
October 1995	25th Plenum of the 14 th CCP Central Committee issued Decision on strengthening of ownership in the state sector by separating the principle of separating the state and holding of state assets.
September 1997	First Plenum of 15 th CCP National Committee called for speeding the progress of reform in large state SOEs from state monopoly to introducing the market which encourages and restricts by the law SOEs to be a market entity, regardless of large and medium-sized SOEs in 2002.
December 1998	Promulgation of the 1998 PRC Securities Law
September 1999	Fourth Plenum of the 15 th CCP Central Committee issued Decision on Several Issues Concerning the reform and strengthening of state-owned enterprises, which aimed to strengthen the ownership reform in large and medium-sized SOEs and establish a modern enterprise system.
November 2001	Change of system to the HSE
November 2002	16 th CCP National Committee called for speeding the pace in the reform of the system to introduce market of state-owned assets which is required and encouraged SOEs.
March 2003	Establishment of non-financial Assets Supervision and Administration Commission (SASAC)
April 2004	China Securities Regulatory Commission issued Notice on Risk and Control concerning the 16 th Plenum of April 26 on the reform of state-owned enterprises and issued the system of control of a company non-financial assets and state-owned assets which should be held by the state.
June 2004	SASAC issued Notice on Strengthening the Establishment and operation of the System of Board of Directors in Wholly State-owned Enterprises, which revised the responsibilities and roles of central SOEs.
October 2005	Promulgation of the 2005 Company Law and the 2005 Securities Law

Appendix 4-1 SOE reform timeline

July 1979	State Council Issued <i>Regulations on the Expansion of Operational and Managerial Autonomy of SOEs</i> . Several other regulations were passed thereafter to grant more operational rights to SOE managers.
December 1986	State Council issued <i>Several Decisions on Deepening Enterprise Reform and Invigorating Enterprise Vitality</i> , which launched the 'enterprise contract responsibility system' among large and medium-sized SOEs.
April 1988	Passage of the <i>Law on Industrial Enterprises Owned by the Whole People</i> which created the legal person status for SOEs and required a 'factory top manager responsibility system' to be implemented in all industrial SOEs
1990-1991	Establishment of Shanghai and Shenzhen Stock Exchanges
November 1993	Third Plenum of the 14 th CCP Central Committee passed <i>Decision on Several Issues Concerning the Establishment of the System of Socialist Market Economy</i> , which set the establishment of the modern enterprise system as the direction for future SOE reform.
December 1993	Promulgation of the 1993 PRC <i>Company Law</i>
October 1995	Fifth Plenum of the 14 th CCP Central Committee called for the strategic adjustment of the layout of the state sector by following the principle of 'grasping the large and letting go of the small'.
September 1997	First Plenum of 15 th CCP National Congress called for turning the majority of medium to large-sized SOEs from loss making to profit-making businesses within three years, and establishing the modern enterprise system within majority of large and medium-sized SOEs by 2000.
December 1998	Promulgation of the 1998 PRC <i>Securities Law</i>
September 1999	Fourth Plenum of the 15 th CCP Central Committee passed <i>Decision on Several Major Issues Concerning the Reform and Development of State-owned Enterprises</i> , which called for deepening the shareholding reform in large and medium-sized SOEs and adopted the concept of corporate governance.
November 2001	China's accession to the WTO
November 2002	16 th CCP National Congress put forward guiding principles for the reform of the system for management of state-owned assets vested in industrial and commercial SOEs.
March 2003	Establishment of State-owned Assets Supervision and Administration Commission (SASAC)
April 2005	China Securities Regulatory Commission issued <i>Notice on Relevant Issues concerning the Pilot Reform of Split Share Structure in Listed Companies</i> , and initiated the reform to convert all previously non-tradable state and state legal person shares into tradeable shares.
June 2004	SASAC issued <i>Notice on Experimenting the Establishment and Improving the System of Board of Directors in Wholly State-owned Enterprises</i> , which initiated the 'Standardised board reform' in central SOEs.
October 2005	Promulgation of the 2005 <i>Company Law</i> and the 2005 <i>Securities Law</i>

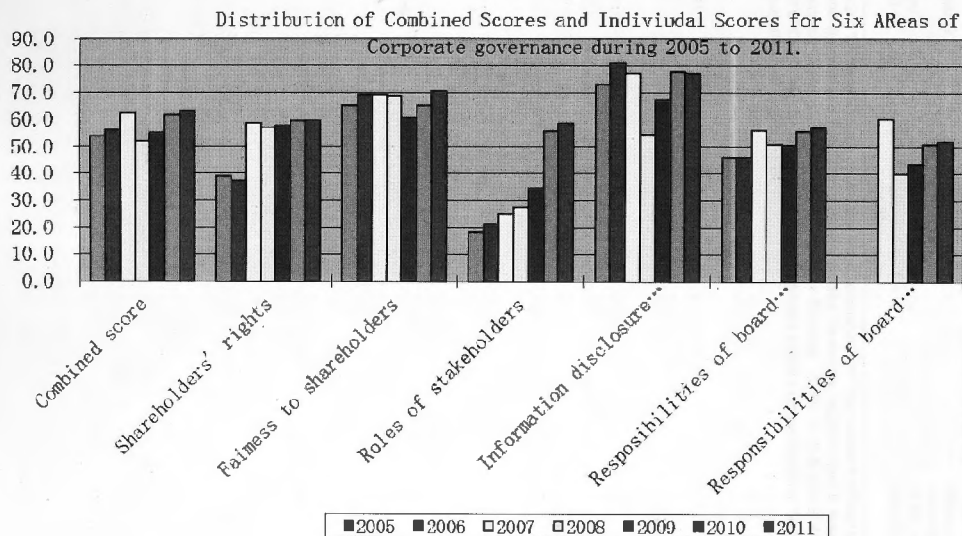
December 2006	State Council issued <i>Guiding Opinion on Promoting the Adjustment of State-owned Capital and Restructuring State-owned Enterprises</i> , which laid the policy basis for SASAC to promote full listing of central SOEs.
December 2007	SASAC issued <i>Guiding Opinion on the Implementation of Corporate Social Responsibility by Central Government-affiliated SOEs</i> .
November 2012	18 th CCP National Congress called for deepening of the consolidation and reform of SOEs to enhance their vitality and capacity to leverage and influence the economy.
November 2013	Third Plenum of the 18 th CCP National Congress called for further reform of SOEs through expanding ownership diversification, strengthening corporate governance and improving the system for the management of state-owned assets.

Appendix 6-1 The Baosteel Corporation board prior to and after the 'standardised board' reform

The Baosteel Corporation board, the first central SOE board that completed the standard board reform, has often been recommended by SASAC as an example for other SOEs to follow. Prior to the 'standardised board' reform, the Baosteel Group Corporation had seven directors, comprising a Chairwoman who was also the General Manager, a deputy Chairman and other five directors who were either senior managers of the Baosteel Group Corporation or its listed subsidiary, Baosteel Limited. Immediately after the reform, the Baosteel Group Corporation board comprised of nine directors including four (inside) executive directors and five external directors. The four executive directors were made up by the Chairwoman, a Deputy Chairman who was also given the role of the company Party Secretary, the General Manager, and an employee representative acted by the head of the company trade union. The five external directors consisted of two retired top executives from other Central-SOEs (China Petro Chemical Corporation and China United Telecommunications Group Corporation), the President of National Accounting Institute affiliated to the State Council and two foreign executives. One of the foreign executives was the former Chairman of Singapore Port Authority and the other was the Chairman of the Hong Kong-based Li&Fung Group, a world leader in supply chain management. According to commentators, the standardised board reform introduced into the Baosteel Corporation not only a better mixture of expertise, but also more checks and balances on the exercise of management powers.²

² 孔维纯 [Sun Weichun], 郭凤琳 [Guo Fenlin], '宝钢集团董事会成立: 9 名成员中外部董事占 5 席' [New Board Formed in Baosteel, Five of the Nine Directors from External] *People's Net News Story* (18 October 2005) <<http://finance.people.com.cn/GB/1039/3778693.html>>.

Appendix 9-1 Centre for Corporate Governance of the China Academy of Social Science (CASS) and Protiviti's Annual Evaluation of Corporate Governance of China's Top 100 Listed Companies—distribution of the combined scores and scores for each area of corporate governance from 2005 to 2011



Source: Compiled from China Academy of Social Science and Protiviti's Assessment Report of Corporate Governance of Top 100 Chinese Listed Companies from 2005 to 2011. A major revision of the assessment criteria was undertaken in 2008, which contributed to the lower scores in some governance areas in that year compared to previous years.

Appendix 9-2 Ownership and governance structures in Chinese top 15 non-financial and top 15 financial listed companies

Categories	Largest Shareholder (LS)	Average Shareholding by LS	Average Size and Composition of Board of Directors	Position of Chairman in LS	Position of Non-independent Directors in LS
Top 15 non-financial companies	SASAC-controlled SOEs (11) Local SASAC-controlled SOEs (3) Ministry of Railway(1)	54.37%	Total 10.6 directors, executives 5 (47%), non-executives 1.6 (15.09%) independent 4.2 (39%)	10 are Chairman (with 9 also Party Secretary) of LS, 4 are General Manager of LS, 1 held by head of Local railway authority	12 companies have all, or all but 1 non-independent, directors from LS. Other 3 companies have majority of executive directors from LS
Top 15 financial companies	Central Huijin (5)Ministry of Finance Ministry/Bureau (2) SOEs(6) Private/foreign institutions (2)	25.99%	Total 15.53 directors, executives 3.46 (21.89%), non-executives 5.4 (34.77) independent 5.4 (34.77)	5 held by senior executives of parent SOEs as LS	Most non-independent directors are from major shareholders. Where company is controlled by Huijin, Huijin appoints all non-executive directors

Source: Compiled from the 2011 Annual Reports of relevant listed companies and the websites of their parent SOEs. The list of China's top 15 Non-financial and Top 15 financial companies (ranked by capitalisation) is from Protiviti and Corporate Governance Research Centre of China Academy of Social Science, 《2012 年中国上市公司一百强治理评价报告》 [Assessment Report of Corporate Governance of Top 100 Chinese Listed Companies 2012] 30-31 <<http://www.protiviti.com/zh-CN/Pages/default.aspx>>.

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